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Notes

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NOTES

Civil Procedure—Relation Back of Barred Counterclaims Under Rule 13(f)

Authority exists for the proposition that the statute of limitations is more properly used as a shield, rather than a sword.[1] More often than not, however, the statute in fact becomes a sword that severs life from a still viable claim for relief. In *Butler v. Poffinberger*,[2] a federal district court prevented an omitted counterclaim from falling prey to the statute of limitations through application of Federal Rules of Civil Procedure 13(f) and 15(c).[3]

On June 10, 1967, Poffinberger and Butler were injured in an automobile collision. Butler filed suit against Poffinberger and his employer in a federal district court,[4] alleging that Poffinberger's negligence proximately caused his injuries. The attorney who represented both Poffinberger and his employer averred that " '[p]laintiff [Butler] was guilty of negligence which proximately contributed in whole or in part to the accident described in the complaint.' "[5] The attorney failed, however, to set forth a counterclaim for Poffinberger's injuries, assuring him later that the matter of any countersuit would be taken care of. In May, 1968, one month before the West Virginia statute of limitations was due to expire, the attorney notified Poffinberger that he would not handle the counterclaim. Three months after the statute expired, Poffinberger filed a motion to amend his answer under rule 13(f).[6] Finding excusable neglect and inadvertence in Poffinberger's failure to assert the counterclaim earlier, the court granted leave to set up the counterclaim by amendment under rule 13(f). Because it " 'arose out of' the precise 'conduct, transaction, or occurrence' on which the answer focused,"[7] the amendment was found to relate back to the date of the answer under rule 15(c).[8] Thus, the terminal effect of the statute of limitations was avoided.

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[1] Northern Pac. Ry. v. United States, 277 F.2d 615, 623 (10th Cir. 1960).
[2] 49 F.R.D. 8 (N.D.W. Va. 1970).
[3] FED. R. CIV. P. 13(f) and 15(c). *See* notes 6 and 8 *infra*.
[4] Jurisdiction was apparently based on diversity of citizenship.
[5] 49 F.R.D. at 9.
[6] FED. R. CIV. P. 13(f) provides: "When a pleader fails to set up a counterclaim through oversight, inadvertence, or excusable neglect, or when justice requires, he may by leave of court set up the counterclaim by amendment."
[7] 49 F.R.D. at 10.
[8] FED. R. CIV. P. 15(c) provides: "Whenever the claim or defense asserted in

In allowing the rule 13(f) amendment to relate back under rule 15(c) the federal district court rejected the reasoning of the Court of Appeals for the Sixth Circuit in *Stoner v. Terranella.*[9] In *Stoner*, the defendant wished to assert an omitted counterclaim upon which the statute of limitations had run; he sought leave to amend his answer under rule 15(a)[10] and argued that the amendment should relate back to the answer under rule 15(c). The court of appeals held that amendment under rule 13(f), rather than rule 15(a), was the proper method of asserting an omitted counterclaim.[11] Commenting that rules 13(f) and 15(a) were "mutually exclusive,"[12] the court added that even had the defendant sought leave to amend under rule 13(f), the amendment would not relate back under rule 15(c). Relation back under rule 15(c) applied only to amendments made pursuant to rule 15(a), not rule 13(f).[13]

Although the court in *Stoner* failed to enunciate the motivating rationale behind the decision, the outcome was most likely justified from a logical standpoint. The court perhaps noted, sub silentio, that relation back of rule 13(f) counterclaims had never before been attempted.[14] Notwithstanding this fact, the court was probably impressed with other cases holding that rule 13 had no application to counterclaims upon which the statutory period had elapsed.[15] Arguably, if rule 13 had no application to counterclaims barred by the statute of limitations, then rule 15(c) could not be used in conjunction with rule 13(f) amendments because the whole

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the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading."

[9] 372 F.2d 89 (6th Cir. 1967).

[10] FED. R. CIV. P. 15(a) provides in part: "A party may amend his pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar, he may so amend it at any time within 20 days after it is served. . . ."

[11] 372 F.2d at 91.

[12] *Id. But see* Smith Contr. Corp. v. Trojan Constr. Co., 192 F.2d 234, 236 (10th Cir. 1951) (leave to amend when justice requires under rule 13(f) should be freely given as required by rule 15(a)); Riss & Co. v. Local 107, Teamsters, 27 F.R.D. 7, 8 (E.D. Pa. 1961) (liberality of amendment applies to both rules 13(f) and 15).

[13] "Consequently since Rule 15(c) is applicable only to amendments made pursuant to Rule 15(a), . . . amendments made pursuant to Rule 13(f) do not relate back to original pleadings." 372 F.2d at 91 (citations omitted).

[14] 1A W. BARRON & A. HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE § 402, at 26 (Supp. 1969) [hereinafter cited as BARRON & HOLTZOFF].

[15] *See* Keckley v. Payton, 157 F. Supp. 820, 822-23 (N.D.W. Va. 1958); Sullivan v. Hoover, 6 F.R.D. 513 (D.D.C. 1947).

purpose of relation back is to avoid the statute of limitations. Even more persuasive, however, was the fact that the drafters of the federal rules gave no indication that rule 13(f) amendments were to relate back under rule 15(c).[16] Indeed, the court in *Stoner* might have reasoned had the drafters intended for rule 13(f) amendments to relate back they could have easily made provision for such an effect. The fact that no such provision was considered, or even commented upon, is some evidence that the rules should not be so used, especially in light of the strong substantive policy reflected by the statute of limitations. There is something inherently unfair in allowing the defendant to withhold his claim until the statutory period has expired, and then permit him to assert it in an amendment that relates back to the date of the pleading. It seems most improper when one considers that the defendant could have easily brought suit as a party plaintiff long before the statute of limitations expired on his claim for relief. The court in *Stoner* thus concluded that the federal rules were not designed to protect defendants who had slept upon their rights.

While the decision in *Stoner* appears correct on the surface, it is submitted that a more extensive analysis might have led that court to reach the opposite result[17] and would indicate that *Poffinberger* was correctly decided. One reason so few defendants have attempted to assert statutorily barred counterclaims through use of rule 15(c) is that most states hold that the statute of limitations is tolled by the filing of the complaint.[18] As a result, in most instances resort to rule 15(c) is not necessary. Fur-

[16] *See* ADVISORY COMMITTEE ON RULES FOR CIVIL PROCEDURE, PRELIMINARY DRAFT OF RULES OF CIVIL PROCEDURE FOR THE DISTRICT COURTS OF THE UNITED STATES AND THE SUPREME COURT OF THE DISTRICT OF COLUMBIA (May 1936); ADVISORY COMMITTEE REPORT ON RULES FOR CIVIL PROCEDURE, PROPOSED RULES OF CIVIL PROCEDURE FOR THE DISTRICT COURTS OF THE UNITED STATES (April 1937).

[17] The court in *Stoner* cited Barron and Holtzoff as authority for the proposition that rule 15(c) applies only to rule 15(a) amendments. Barron and Holtzoff does impart that "[t]he question whether an amendment relates back under rule 15(c) is of importance only with regard to those amendments made pursuant to rule 15(a)." 1A BARRON AND HOLTZOFF § 448, at 760 (1960). However, a proper reading of that section indicates that the authors were speaking of excluding *rule 15(b)* from the operation of the relation back provision. *Id.* Indeed, Barron and Holtzoff's review of *Stoner* provides that "[t]his is not a necessary reading of the rules, and if the other tests of relation back are satisfied, the doctrine seems as desirable applied to counterclaims as to any other amended pleading." *Id.* § 448, at 74 (Supp. 1969).

[18] *E.g.*, Azada v. Carson, 252 F. Supp. 988, 989 (D. Hawaii 1966) (citing Hawaii law); E.W. Bliss Co. v. Cold Metal Process Co., 156 F. Supp. 63, 66 (N.D. Ohio 1957) (citing Ohio law), *aff'd*, 285 F.2d 231 (6th Cir. 1960), *cert. denied*, 366 U.S. 911 (1961); Tom Reed Gold Mines v. Brady, 55 Ariz. 133, 139, 99 P.2d 97, 100 (1940).

thermore, reliance upon cases[19] holding that rule 13 has no application to barred counterclaims seems unwarranted; no attempt was made in those cases to bring the counterclaim within the scope of rule 15(c). Rather, the cases focused upon whether the language of rule 13(c)[20] allowed the counterclaims to be asserted regardless of whether the statute of limitations had run.

The absence of an express federal rule covering relation back of counterclaims may have improperly influenced the court in *Stoner*. Rule 15(c) was obviously designed to alleviate the problems encountered when the statutory period elapsed after a pleading was filed, leaving the claims and defenses arising from a single transaction inadequately reflected. The drafters of the federal rules allowed amended pleadings setting forth these omitted matters to relate back, recognizing that once an opposing party has been put on notice as to the transaction being litigated the purpose of the statute of limitations has been served.[21] Unlike in *Stoner*, the court in *Poffinberger* recognized that allowing counterclaims to relate back comports to this policy of notification equally as well as other amended pleadings. If the policy of the federal rules is to decide cases on their merits and not on technicalities,[22] the statute of limitations should not bar defendant's same-transaction-counterclaims.

The logical place to begin an interpretive inquiry into the correct meaning of the federal rules is the language of the rules themselves. Rule 13(f) states that the "[defendant] may by leave of court set up the counterclaim by amendment."[23] Rule 15(c) requires only that an "amendment" arise from the same transaction as the original pleading.[24] There is nothing in the language of the two rules to indicate that the term "amendment" in rule 15(c) does not apply to amendments asserting omitted counterclaims under rule 13(f). There is certainly no indication that rule 15(c) applies only to amendments made pursuant to rule 15(a).[25] Moreover, rule 13(f) amendments meet the requirements of

[19] Keckley v. Payton, 157 F. Supp. 820, 822-23 (N.D.W. Va. 1958); Sullivan v. Hoover, 6 F.R.D. 513 (D.D.C. 1947).

[20] FED. R. CIV. P. 13(c) states in part that "[a] counterclaim may . . . diminish or defeat the recovery sought by the opposing party."

[21] *See generally* F. JAMES, CIVIL PROCEDURE § 10.17 (1965) [hereinafter cited as JAMES].

[22] Copeland Motor Co. v. General Motors Corp., 199 F.2d 566, 567-68 (5th Cir. 1952).

[23] FED. R. CIV. P. 13(f).

[24] Fed. R. Civ. P. 15(c).

[25] "If . . . [rule 15(c)] was meant to encompass less than all the amendments

rule 15(c) that the claim set up by amendment arise from the same transaction as the original pleading. If, as in *Poffinberger*, the counterclaim arises from the same occurrence set forth in the original pleading, the plaintiff has the required notice and relation back should be allowed. When careful examination of the language of the rules is combined with the policy of liberal construction of the amending provisions,[26] it is clear that the decision in *Poffinberger*, rejecting the reasoning of the court in *Stoner*,[27] was correct. Rule 13(f) amendments should be allowed to relate back under rule 15(c).[28]

There is at least one narrow situation where the relation back theory of *Poffinberger* may prove unworkable: where the plaintiff's complaint is filed so near the expiration date of the statute of limitations, that the answer, even though timely under rule 12(a),[29] is served after the statute has run.[30] A rule 13(f) amendment asserting a barred counterclaim and relating back to the time of *the answer*, as in *Poffinberger*, would still be barred by the statute of limitations. In order to alleviate his plight, the defendant could urge that since the counterclaim asserted in his amended pleading arose out of the same conduct, transaction, or occurrence with which the suit is concerned, the court should interpret "original pleading" in rule 15(c) to mean the plaintiff's complaint, not the defendant's answer. From a policy standpoint, the court should recognize that the purpose of the statute of limitations is to keep stale litigation out of the court.[31] It should be aimed at barring untimely lawsuits, rather

authorized by the Federal Rules, one would expect some indication of that fact within the Rule." 49 F.R.D. at 11.

[26] Commissioner v. Finley, 265 F.2d 885, 888 (10th Cir.), *cert. denied*, 361 U.S. 834 (1959).

[27] It is at least plausible that the court in *Stoner* wanted to avoid deciding whether relation back was substance or procedure under *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). This avoidance seems unnecessary in light of the Supreme Court's decision in *Hanna v. Plumer*, 380 U.S. 460 (1965), which apparently directs a federal court to apply the federal rule of relation back. *Id.* at 471. *See also* 3 J. MOORE, FEDERAL PRACTICE ¶ 15.15[2] (2d ed. 1968) [hereinafter cited as MOORE].

[28] *Cf.* 1A BARRON AND HOLTZOFF § 448, at 74 (Supp. 1969).

[29] FED. R. CIV. P. 12(a) states in part: "A defendant shall serve his answer within 20 days after service of the summons and complaint. . . ."

[30] Allowing the plaintiff's claim to be litigated while barring the defendant's counterclaim might well encourage the plaintiff to utilize the statute of limitations to avoid the defendant's counterclaims. This result is diametrically opposed to the purpose of statutes of limitation. *See e.g.*, Azada v. Carson, 252 F. Supp. 988, 989 (D. Hawaii 1966) (complaint was filed two days before the statute ran). *See generally* JAMES § 10.17, at 489.

[31] *Cf.* JAMES § 10.17, at 489.

than justiciable issues still capable of litigation.[32] The statute was designed to "assure fairness . . . 'by preventing surprises through the revival of claims which had been allowed to slumber . . . .' "[33] If it were held that the term "original pleading" in rule 15(c) meant the plaintiff's complaint, the rule in some jurisdictions that the statute of limitations is not tolled by the filing of the complaint[34] would be completely circumvented. The federal court would not only be able to adjudicate a complete controversy arising out of the same transaction, but the plaintiff would be precluded from using a statute initially designed to protect defending parties[35] as an offensive weapon.[36]

If the complaint is interpreted as the "original pleading" for purposes of rule 15(c), consequently tolling the statute of limitations, the issue becomes that of protecting the plaintiff from an intentionally dilatory defendant. Rule 13(f) demands that defendant's failure to assert timely an omitted counterclaim result from oversight, inadvertence, or excusable neglect; leave to amend will not be granted if failure to assert the counterclaim was for a frivolous reason. On the other hand, if defendant's failure to raise the counterclaim was truly inadvertent, as in *Poffinberger*, leave to amend will be granted, but the plaintiff will not be prejudiced, "at least not in a way the statute of limitations was designed to protect."[37]

Although federal court defendants can rely on the court's interpretation in *Poffinberger* of the relationship between rules 13(f) and 15(c), the impact of the decision may have far-reaching consequences for those states that adhere to the view that the statute is not tolled by the filing of the complaint and have adopted rules of procedure similar to the federal rules. In North Carolina, for example, the cases suggest that the statute of limitations continues to run after the filing of the complaint.[38] What

[32] United States v. Western Pac. R.R., 352 U.S. 59, 72 (1956).

[33] Burnett v. New York Cent. R.R., 380 U.S. 424, 428 (1965).

[34] Many jurisdictions hold that the filing of the complaint tolls the statute of limitations only as to claims for recoupment, *i.e.*, the defendant can assert a claim arising out of the same transaction to prevent or reduce the plaintiff's recovery, but he cannot affirmatively recover. *See, e.g.*, Bull v. United States, 295 U.S. 247, 262 (1935); Harvey Coal Corp. v. Smith, 268 S.W.2d 634 (Ky. 1954).

[35] Burnett v. New York Cent. R.R., 380 U.S. 424, 428 (1965).

[36] *See generally* Northern Pac. Ry. v. United States, 277 F.2d 615, 623 (10th Cir. 1960); JAMES § 10.17.

[37] 3 MOORE ¶ 15.15[2], at 1022. *See also* JAMES § 10.17.

[38] B-W Acceptance Corp. v. Spencer, 268 N.C. 1, 149 S.E.2d 570 (1966); Speas v. Ford, 253 N.C. 770, 117 S.E.2d 784 (1961); *cf.* North Carolina Cotton Grower's Co-op. v. Tillery, 201 N.C. 531, 533, 160 S.E. 767, 768 (1931) (dictum). *Contra*, Norfolk & S.R.R. v. Dill, 171 N.C. 176, 177, 88 S.E. 144, 145 (1916); Brumble v.

result can be anticipated when a defendant fails to assert a counterclaim upon which the statutory period has elapsed? If the North Carolina courts adopt the rationale used in *Poffinberger*, the statute will be effectively tolled with respect to the counterclaim the defendant has failed to allege. Rule 13(f)[39] of the North Carolina rules is to identical to the federal rule. However, North Carolina rule 15(c)[40] is somewhat different. It provides that

> [A] claim asserted in an amended pleading is deemed to have been interposed at the time the claim in the original pleading was interposed, unless the original pleading does not give notice of the transactions, occurrences, or series of transactions or occurrences, to be proved pursuant to the amended pleading.[41]

The defendant will probably be allowed to assert a statutorily barred counterclaim if his answer apprises the plaintiff of the transaction upon which his claim rests.[42] The official comment to the North Carolina rules indicates such a result by stating that "[t]he amended pleading will . . . relate back . . . even if the new pleading constitutes a new cause of action, provided that the defending party had originally been placed on notice of the events involved."[43]

In those jurisdictions in which the *Poffinberger* rationale is adopted, many of the vestiges of a harsh, inequitable, and often confusing rule can be eliminated. Subject to rule 13(f) safeguards, the plaintiff no longer will be allowed recovery while the defendant's claim for relief arising from the same transaction is barred by the statute of limitations. Upon a showing of inadvertence or excusable neglect, the defendant should be allowed to assert an omitted counterclaim by amendment, and the amendment

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Brown, 71 N.C. 513, 516 (1874). *See generally* 1 McINTOSH, NORTH CAROLINA PRACTICE AND PROCEDURE § 327, at 206 (2d ed. 1956).

[39] N.C.R. CIV. P. 13(f).

[40] N.C.R. CIV. P. 15(c).

[41] *Id.* North Carolina rule 15(c) was modeled after the New York procedural rule governing amended pleadings, N.Y. CIV. PRAC. LAW § 203(e) (McKinney 1963). That rule has been interpreted as allowing the relation back of barred counterclaims if an affirmative defense is alleged in the answer. Such a defense would give the plaintiff notice of the transactions to be proved in the amended pleading. *A Biannual Survey of New York Practice*, 39 ST. JOHN'S L. REV. 412-13 (1965).

[42] Based upon New York's experience under a similar rule, North Carolina courts may allow relation back of barred counterclaims only when the answer has set forth an affirmative defense alleging the precise conduct to be proved in the amended pleading. *See* Nichimen & Co. v. Framen Steel Supply Co., 44 Misc. 2d 260, 253 N.Y.S.2d 713 (Sup. Ct. 1964).

[43] N.C.R. CIV. P. 15, comment (c).

should be allowed to relate back to the "original pleading" to avoid the bar of the statute. "[I]t is a natural and salutary development to toll the statute of limitations on all causes of action arising out of the transaction initially pleaded, regardless of legal theory."[44]

C. H. POPE

Civil Procedure—Remittitur—Remitting Parties' Right to Cross-Appeal

With its recent decision in *Mulkerin v. Somerset Tire Service, Inc.*[1] New Jersey allied itself with Wisconsin[2] in permitting a plaintiff who had accepted remittitur in the trial court to obtain appellate review of the lower court's determination of the damage issue by means of a cross-appeal. In so doing, New Jersey broke with widely accepted precedent at common law which denies all opportunities to the remitting party to complain on appeal.[3] Although four states currently provide the remitting party with some method for review by statute or rule of civil procedure,[4] only Wis-

[44] McLaughlin, *Practice Commentary*, N.Y. CIV. PRAC. LAW § 203(e) (McKinney 1963).

[1] 110 N.J. Super. 173, 264 A.2d 748 (App. Div. 1970).

[2] *See, e.g.*, Plesko v. City of Milwaukee, 19 Wis. 2d 210, 120 N.W.2d 130 (1963).

[3] Conlin v. Southern Pac. R.R. 182 P. 71 (Cal. Dist. Ct. App. 1919); Sergeant v. Watson Bros. Transp. Co., 244 Iowa 185, 52 N.W.2d 86 (1952); Iron R.R. v. Mowrey, 36 Ohio St. 418 (1881).

[4] NEB. REV. STAT. § 25-1929 (1943):

> Whenever the court shall direct a remittitur in any action, and the same is made, and the party for whose benefit it is made shall appeal said action, then the party remitting shall not be barred from maintaining that the remittitur should not have required either in whole or in part.

N.Y. CIV. PRAC. LAW § 5501 (McKinney 1963):

> (a) An appeal from a final judgment brings up for review:
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> . . . .
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> 5. a verdict after a trial by jury as of right, when the final judgment was entered in a different amount pursuant to the respondent's stipulation on a motion to set aside the verdict as excessive or inadequate; the appellate court may increase such judgment to a sum not exceeding the verdict or reduce it to a sum not less than the verdict.

TENN. CODE ANN. § 27-118 (1955):

> In all jury trials had in civil actions, after the verdict has been rendered, and on motion for a new trial, when the trial judge is of the opinion that the verdict in favor of a party should be reduced, and a remittitur is suggested by him on that account, with the proviso that in case the party in whose favor the verdict has been rendered refuses to make the remittitur a new trial will be awarded, the party in whose favor such verdict has been rendered may make such remittitur under protest, and appeal from the action of the trial judge to the Court of Appeals; and if, in the opinion of said Court of

consin and New Jersey offer this oppotrunity by judicial action. This note will explore the implications of the Wisconsin rule[5] as adopted by New Jersey and compare its effects with both the general rule[6] and those statutory or procedural schemes which allow the successful party to challenge the trial court's decision regarding the excessiveness of the original verdict.

Mulkerin involved a suit for personal injuries sustained by the plaintiff, an elderly patron of the defendant's service station, who fell in the station's icy driveway. On her claim for negligence the jury awarded her damages of forty-eight thousand dollars, and her husband, fifty-five hundred dollars on his *per quod* claim. Believing this award to be excessive, the trial court granted a conditional new trial on damages, subject to being defeated if the plaintiff would accept a ten thousand dollar remittitur.[7] Mrs. Mulkerin consented and judgment was entered from which the defendant took an appeal. Following the defendant's lead, Mrs. Mulkerin then cross-appealed from the court's action in remitting ten thousand dollars of her verdict.[8]

In deciding that Mrs. Mulkerin should be given the right to cross-appeal, the court relied heavily on the practical benefits offered by remittitur. Pointing out that a plaintiff's acceptance of remittitur is influenced by his desire to avoid the delay, expense and risk incident to a new trial or an appeal, the court reasoned that these objectives are frus-

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Appeals, the verdict of the jury should not have been reduced, but that the judgment of the trial court is correct in other respects, the case shall be reversed to that extent, and judgment shall be rendered in the Court of Appeals for the full amount originally awarded by the jury in the trial court.

TEX. R. CIV. P. 328:

New trials may be granted when the damages are manifestly too small or too large, provided that whenever a court shall direct a remittitur in any action, and the same is made, and the party for whose benefit it is made shall appeal in said action, then the party remitting shall not be barred from contending in the appellate court that said remittitur should not have been required either in whole or in part, and if the appellate court sustains such contention it shall render such judgment as the trial court should have rendered without respect to said remittitur.

[5] Because the decision in Plesko v. City of Milwaukee, 19 Wis. 2d 210, 120 N.W.2d 130 (1963), preceded the *Mulkerin* holding by seven years, the rule that a remitting party may cross-appeal for review of the reduced verdict will be referred to as the Wisconsin rule throughout this note.

[6] In the interest of simplicity, the rule which denies a plaintiff who has accepted remittitur the right to challenge the trial court's determination on appeal will be referred to as the general rule.

[7] 110 N.J. Super. at —, 264 A.2d at 749.

[8] *Id.* at —, 264 A.2d at 749.

trated when the party for whose benefit the remittitur was ordered appeals.[9] In such a case the plaintiff loses the advantages of his acceptance since he is forced to defend the trial court's decision on liability. The attempt at judicial economy is also frustrated by the increased calendar congestion caused by the defendant's appeal. Like the Wisconsin court in *Plesko v. City of Milwaukee*,[10] the court in *Mulkerin* concluded that basic ideas of fairness argue against a defendant's receiving the benefits of both a reduced verdict and an opportunity to appeal on all issues without risking a reinstatement of the original verdict.[11]

The pragmatic approach of the Wisconsin rule appears most equitable when compared to the harsh simplicity of the general rule. This is not to say, however, that the general rule is without logical basis. Whether phrasing the nonappealability in terms of waiver,[12] estoppel,[13] or lack of standing,[14] the common thread running through the decisions is the theory that one may not appeal from a judgment to which he has consented.[15]

In reaching this analogy with consent judgments in general, the courts follow a fairly uniform scheme of analysis. An examination of their decisions indicates that remittitur is considered to serve a dual function: First, it is the equivalent of a certificate, that, in the opinion of the court, the original verdict cannot be supported.[16] Second, it represents an option offered out of fairness to the verdict winner to save him the difficulties incident to a second trial.[17] In suggesting that he remit the excessive portion of his recovery, the court provides the plaintiff with an opportunity

[9] *Id.* at —, 264 A.2d at 750.

[10] 19 Wis. 2d at 221, 120 N.W.2d at 135.

[11] 110 N.J. Super. at —, 264 A.2d at 750.

[12] *E.g.*, San Bernadino County v. Riverside County, 135 Cal. 618, 67 P. 1047 (1902); Plinsky v. Nolan, 65 Ore. 402, 133 P. 71 (1913).

[13] *E.g.*, Florida E. Coast Ry. v. Buckles, 83 Fla. 599, 92 So. 159 (1922); McDaniel v. Hancock, 328 Mich. 78, 43 N.W.2d 68 (1950); Martin v. Jansen, 113 Wash. 290, 193 P. 674 (1920).

[14] *E.g.*, Gough v. Halperin, 306 Pa. 230, 159 A. 447 (1932); *accord*, Clarkson v. Crawford, 285 Pa. 299, 132 A. 350 (1926).

[15] *E.g.*, City of Bessemer v. Brantley, 258 Ala. 675, 65 So. 2d 160 (1953); Andres v. Green, 7 Ill. App. 2d 375, 129 N.E.2d 430 (1955); Los Angeles & S.L.R. Co. v. Umbaugh, 61 Nev. 214, 123 P.2d 224 (1942); Fleming v. Smouse, 73 W. Va. 188, 80 S.E. 144 (1913).

[16] Ralston v. Philadelphia Rapid Transit Co., 267 Pa. 278, 284, 110 A. 336, 338 (1920). Although remittitur is not proper where the verdict is influenced by passion or prejudice so as to affect the issue of liability, it may be used in this first function to correct a verdict which is merely excessive. Comment, *Remittitur: Or the Law of Diminishing Returns*, 24 TENN. L. REV. 1155, 1159 (1957).

[17] Corabi v. Curtis Publishing Co., 437 Pa. 143, —, 262 A.2d 665, 669 (1970).

to prevent the expense and delay of further litigation. At the same time the court saves itself valuable time and the risk that the same result might again obtain when the case is retried. By construing the order which grants the new trial in conditional terms, the plaintiff is given the privilege of retaining that portion of the verdict not deemed excessive and defeating the defendant's demand for a new trial.[18]

It is in this second function of remittitur that the courts which follow the general rule find the basis for their argument. They observe that while a plaintiff has no claim to remittitur as a matter of right, neither can it be forced upon him without his assent.[19] If he is dissatisfied he may reject the remittitur and either proceed to a second trial or, in many cases, take an appeal from the order which granted the new trial.[20] In either case he will be faced with the same situation as if there had been no suggestion for him to remit in the first place.[21] The argument concludes that when the plaintiff files his acceptance, he has made an election to which he is bound.[22] Any subsequent assertion that he is entitled to more would be wholly inconsistent with his prior election to accept the reduced amount in full satisfaction of his claim against the defendant.[23]

It is arguable, though, that the limited options available under the general rule may not always provide the plaintiff with a viable means of protecting his self-interest. From his viewpoint, the dilemma may take on the following character: If he accepts the reduction in verdict, then he consents to receive an amount which he deems inadequate. If he rejects the reduction without appealing the order which granted the new trial, then he must undergo the time and expense of a second trial with the risk

[18] Carver v. Missouri-Kansas-Texas R.R., 362 Mo. 897, 916, 245 S.W.2d 96, 105 (1952).

[19] *Compare* Corabi v. Curtis Publishing Co., 437 Pa. 143, —, 262 A.2d 665, 669 (1970) *with* Andres v. Green, 7 Ill. App. 2d 375, 384, 129 N.E.2d 430, 434 (1955) *and* Alabama & V. Ry. v. Davis, 69 Miss. 444, 451, 13 So. 693, 695 (1891).

[20] Generally, the discretion of the trial court in ruling on a motion for a new trial based on excessiveness of damages is subject to review or reversal, but only for a clear abuse or arbitrary exercise of discretion. *See, e.g.*, Prosser v. Richman, 133 Conn. 253, 50 A.2d 85 (1946); Thomas v. Fleming, 241 Miss. 26, 128 So. 2d 854 (1961); Dodd v. Missouri-Kansas-Texas R.R., 354 Mo. 1205, 193 S.W.2d 905 (1946). *Cf.* Busch, *Remittiturs and Additurs in Personal Injury and Wrongful Death Cases*, 12 DEFENSE L.J. 521, 528 (1963) [hereinafter cited as Busch]. *But see* Andres v. Green, 7 Ill. App. 2d 375, 129 N.E.2d 430 (1955), in which it is suggested that there is no right of appeal in this situation.

[21] Corabi v. Curtis Publishing Co., 437 Pa. 143, —, 262 A.2d 665, 669 (1970).

[22] *E.g.*, Dargis v. Maguire, 156 So. 2d 897, 898 (Fla. App. 1963); Iron R.R. v. Mowery, 36 Ohio St. 418, 423 (1881). In both of these cases the plaintiffs' acceptance, through reluctantly or conditionally given, was deemed to have been absolute.

[23] Corabi v. Curtis Publishing Co., 437 Pa. 143, —, 262 A.2d 665, 668 (1970).

that he may again be forced to accept what he believes to be an inadequate verdict. If he is able to appeal the order which granted the new trial, he must not only defend his position against all other grounds asserted in the defendant's motion, but he must also defend the reasonableness of the original verdict, even though he may consider it excessive in some amount. This latter problem becomes especially acute when the reduction amounts to a high precentage of the original verdict.[24]

Only Tennessee meets this problem head-on by enabling the plaintiff to accept the remittitur under protest and then appeal directly from the action of the trial court.[25] Despite its obvious benefit to the plaintiff, this method provides no incentive to achieve finality at trial because the plaintiff's right to appeal is completely independent of the defendant's action following judgment in the lower court. In contrast, the Wisconsin rule encourages the defendant to make a considered appraisal of the merits of his appeal prior to seeking review.[26] Since the plaintiff's right to appellate review is limited to cross-appeal, the defendant tends to think twice before appealing and thereby opening the door to the higher court for the palintiff. Like the Wisconsin rule, statutes in Nebraska[27] and New York[28] and a Texas rule of civil procedure[29] also encourage such judicial economy. At the same time they also provide some alleviation to the dilemma outlined in the previous paragraph in the event the defendant initiates the appeal process.

At first blush, the reasoning of the Wisconsin rule appears to be eminently fair. Implicit in its holding, however, is the basic notion of an appellate tribunal's competence in the area of damage determination—an assumption which is subject to some question.[30] Although higher courts have in the past found justification for imposing remittitur in the "economic

[24] *Id.* at —, 262 A.2d at 669. In *Corabi*, a suit for libel, slander, unfair competition and invasion of privacy, the plaintiffs' verdict had been reduced by sixty per cent in the trial court. Rather than face the problems of a second trial or be forced to defend the reasonableness of the original verdict on appeal, the plaintiffs accepted the remittitur. The acceptance, however, was conditioned by the statement that they retained whatever rights they might have had to seek appellate review. The court had little sympathy for their dilemma and held that the conditional acceptance amounted to an absolute rejection.

[25] TENN. CODE ANN. §§ 27-118, -119 (1955). See note 4 *supra*.

[26] *See* 110 N.J. Super. at —, 264 A.2d at 750.

[27] NEB. REV. STAT. § 25-1929 (1943). See note 4 *supra*.

[28] N.Y. CIV. PRAC. LAW § 5501 (McKinney 1963). See note 4 *supra*.

[29] TEX. R. CIV. P. 328. See note 4 *supra*.

[30] *See* Busch 521; Conklin, *Appellate Courts and the Quest for Just Compensation*, 42 N.D.L. REV. 397 (1966) [hereinafter cited as Conklin].

aspects of justice,"[31] the practical expertise of the appellate judges[32] and the need for uniform awards in comparable cases,[33] such reasoning cannot discount the fact that the only criterion for determination before the court is the cold statement of the trial record. Demeanor evidence and indications of a jury compromise, often invaluable to the trial judge in assessing the supportability of the original award, are totally absent at the appellate level. For this reason some degree of judicial restraint appears to be necessary, lest the higher courts find themselves embroiled in the sort of particularization best served at the trial level. As stated by Professor Conklin,

> [L]ower courts sit to resolve all controversies which come within their jurisdiction because the alternative is chaos. Appellate tribunals sit to render principled judgment of more general applicability by reviewing what has already been authoritatively determined at an inferior level. When appellate courts become activists and particularists they risk the danger of fomenting the primordeal chaos which the lower courts seek to order initially and, usually, quite adequately.[34]

The degree of restraint actually exercised in this situation is necessarily dependent on the scope of review which the court adopts. The court in *Plesko* held that the trial judge's determination would not be disturbed unless it amounted to an abuse of discretion.[35] Although *Mulkerin* established no specific test by which to judge future cases, its language is strongly suggestive of the *Plesko* standard.[36] Since remittitur is a dis-

[31] Conklin 399. He defines this term as "an attempt to do substantial justice in the shortest time possible."

[32] The point of interference is not fixed on the caprice of judicial individualism; it is rather arrived at by a synthesis of all the experience that the judge has had: in the beginning as a law student, in the later controversies of law practice, in the hearing of cases and the writing of decisions, in the sum of all that he has observed in the courtroom and the library.
Mann v. Hunt, 283 App. Div. 140, —, 126 N.Y.S.2d 823, 824 (1953).

[33] *See, e.g.*, Carver v. Missouri-Kansas-Texas R.R., 362 Mo. 897, 918, 245 S.W.2d 96, 107 (1952). For views doubting the validity of such justification see Busch at 542 and Hooker, *The Adequate Award: Tennessee Trends*, 23 TENN. L. REV. 760 (1955).

[34] Conklin 403.

[35] 19 Wis. 2d at 221-22, 120 N.W.2d at 135.

[36] In light of defense counsel's argument before us, . . . we have the impression that he never seriously questioned the extent of Mrs. Mulkerin's injuries. If the remittitur was imposed by the court to mould the amount of Mrs. Mulkerin's verdict because of the foreman's statement that they gave her "wages for six years thirty thousand dollars; pain and anguish eighteen

cretionary tool,[37] such a standard appears to be the only reasonable form of verbalization. Nevertheless, the phrase "judicial discretion" has a tendency to produce some confusion in practice. "This phrase, though possessing some connotation of restriction, could well be likened unto a seemingly boundless judicial playground compassed about at some distant point by an irregular fence called propriety."[38] Although such imprecision is not uncommon in legal standards, it should be cautiously observed in this area. The broader the discretion which is invested in the lower courts, the more likely both they and their juries will be to exert greater care and competence at the trial level.[39] Only where the appellate court is convinced that the trial judge acted irrationally in suggesting remittitur should it interfere; if reasonable men could differ, the higher court should affirm.[40]

Although *Plesko* forged the theoretical break with the general rule, it remained for *Mulkerin* to declare that an actual abuse of discretion had occurred.[41] In so doing, the court restored the original verdict without considering other possible amounts. In view of the general recognition of the power of state appellate courts to impose remittitur and additur in the first instance,[42] it can be assumed that, had the court in *Mulkerin* wished to restore less than the full amount, it could have done so without difficulty. Although the court may have had the ability to restore less than the full amount, this fact alone does not solve the problem of precisely what standard should be used in determining the recovery allowed. The court leaves unanswered whether they shall, in the future, look to the greatest amount a reasonable jury could have awarded, the smallest amount, or somewhere in between. It is arguable that New Jersey's adoption of the Wisconsin rule will carry with it adherence to the standard observed by the Wisconsin courts. In *Powers v. Allstate Insurance Co.*[43] the Wisconsin court rejected their previous yardstick of "the lowest amount for which

thousand dollars," the court's action cannot be sustained. He made a substantive determination that was solely the jury's province.
110 N.J. Super. at —, 264 A.2d at 750.

[37] *See* Hollinger v. York Ry., 225 Pa. 419, 426, 74 A. 344, 345 (1909).

[38] Comment, *Remittitur: Or the Law of Diminishing Returns*, 24 TENN. L. REV. 1155, 1157 (1957).

[39] Conklin 406.

[40] *Id.*

[41] *See* note 36 *supra.*

[42] Conklin 398. *See also* Southern Nat'l Ins. Co. v. Williams, 224 Ark, 938, 277 S.W.2d 487 (1955); Pitrowski v. New York, C. & St. L. R.R., 6 Ill. App. 2d 495, 128 N.E.2d 577 (1955).

[43] 10 Wis. 2d 78, 102 N.W.2d 393 (1960).

the court would permit a verdict to stand"[44] and adopted what it considered to be the majority rule. This latter rule allows the plaintiff to recover "an amount which the court considers reasonable."[45] Although the court's attention in that case was directed at achieving finality at trial, it would seem incongruous—and certainly more confusing—to adopt one standard for trial and another for appeal. In any event, the difficulty in fitting an exact dollar amount to the standard adopted will be magnified since the appellate court is one step further removed from the interplay of facts which give rise to certainty at the trial level.

Assuming that we are safe in attributing to the judiciary a degree of objectivity, insight and forbearance, then the Wisconsin rule may prove to be a valuable procedural tool. While not completely foreclosing appellate review to the remitting party, its limitation of applicability to cross-appeals tends to discourage frivolous appeals by defendants. In this respect, it could work to bring finality to more trial court decisions. Its inherent fairness leaves little room for criticism. Indeed its only defect—if it may properly be called such—is an underlying faith in the ability of appellate courts to pass upon damages. With a recognition of their own weaknesses in this area, however, appellate courts could easily avoid this problem through a degree of judicial restraint.

WILLIAM W. MAYWHORT

Constitutional Law—State Action—You Can't Take the City Out of the Park, But You Can Take the Park Out of the City

In 1966 the Supreme Court ruled that Baconsfield Park in Macon, Georgia, had acquired such "momentum" as a public facility that the mere changing from trustees who were public officials acting in their official capacity to private trustees would not dissipate the unconstitutional state action sufficiently to permit the park to be operated on a segregated basis.[1] By 1970 that momentum seemed to have run out. In *Evans v. Abney*[2] the Court ruled that the decision of the Georgia courts that the park must revert to the heirs of the testator did not involve sufficient state action to violate the fourteenth amendment.

[44] *Id.* at 90, 102 N.W.2d at 400.
[45] *Id.*

[1] Evans v. Newton, 382 U.S. 296 (1966).
[2] 396 U.S. 435 (1970).

In 1911 Augustus O. Bacon had executed a will that devised to the Mayor and Council of the City of Macon a tract of land in trust for the use of the white women and children of Macon as a park and pleasure ground. Eventually the trustees, realizing that they could not legally operate a segregated park,[3] permitted Negroes to use the park facilities. Members of the board of managers, set up under the will to control the park,[4] brought an action in the Georgia courts to remove and replace the trustees for breach of trust. Several Negro citizens then intervened seeking to insure the integration of the park.[5] The case, *Evans v. Newton*,[6] eventually reached the Supreme Court of the United States which held that the park could not be operated on a segregated basis by the trustees designated under the will or any other newly appointed private trustees. Following this decision the Supreme Court of Georgia ruled that the trust had failed and remanded the case to the trial court to determine the disposition of the property.[7] There the Negro intervenors and the Attorney General of Georgia[8] urged that the court apply the doctrine of cy pres[9] and excise the discriminatory language. The trial court however

[3] *See* Pennsylvania v. Board of Directors of City Trusts, 353 U.S. 230 (1957) (per curiam) (agent of state violates fourteenth amendment when, acting as trustee, it discriminates on basis of race).

[4] The will provided:

> [A]ll right, title and interest in and to said property . . . shall thereupon vest in and belong to the Mayor and Council of the City of Macon, and to their successors forever, in trust for the sole, perpetual and unending, use, benefit and enjoyment of the white women, . . . and white children of the City of Macon to be by them forever used and enjoyed as a park and pleasure ground, subject to the restrictions, government, management, rules and control of the Board of Managers hereinafter provided for. . . . The members of this Board shall . . . be selected and appointed by the Mayor and Council of the City of Macon . . . .

Record at 19, Evans v. Newton, 382 U.S. 296 (1966).

[5] Certain heirs of Bacon also intervened asking for a reversion of the trust should the prayer for removal of the trustees be denied but the trial court did not find it necessary to rule on the reversion since new trustees had been appointed. Newton v. City of Macon, 9 RACE REL. L. REP. 309, 310 (Ga. Super. Ct. 1964).

[6] 382 U.S. 296 (1966).

[7] 221 Ga. 870, 148 S.E.2d 329 (1966).

[8] By statute the Attorney General or solicitor general of the situs of the trust represents the interests of the beneficiaries in all legal matters pertaining to the administration and disposition of charitable trusts. GA. CODE ANN. § 108-212 (1969).

[9] GA. CODE ANN. § 108-202 (1959) provides:

> When a valid charitable bequest is incapable for some reason of execution in the exact manner provided by the testator, donor or founder, a court of equity will carry it into effect in such a way as will as nearly as possible effectuate his intention.

GA. CODE ANN. § 113-815 (1959) provides:

held that the will lacked the general charitable intent necessary to the application of cy pres;[10] that the racial discrimination was an essential and inseparable part of the testator's plan; and that, since the will did not provide for an alternate disposition of the property in the event of the failure of the trust, it reverted to the heirs of the testator.[11] The Supreme Court of Georgia affirmed, rejecting the contention that to do so would be judicial enforcement of racial discrimination amounting to a denial of equal protection in violation of the fourteenth amendment.[12] On certiorari the Supreme Court of the United States affirmed the Georgia decision because the Court did not find sufficient state action to attribute the discrimination to the state.[13]

The Court's holding is somewhat surprising in view of its recent willingness to find discriminatory state action in civil rights cases[14] and in view of *Shelley v. Kraemer*,[15] which, at first glance, would seem to dictate a reversal.

Shelley concerned the use of state courts to enforce racial restrictive covenants involving residential housing. The covenants were being used

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A devise or bequest to a charitable use will be sustained and carried out in this state; and in all cases where there is a general intention manifested by the testator to effect a certain purpose, and the particular mode in which he directs it to be done shall fail from any cause, a court of chancery may, by approximation, effectuate the purpose in a manner most similar to that indicated by the testator.

[10] In some cases . . . it appears that the accomplishment of the particular purpose and only that purpose was desired by the testator and that he had no more general charitable intent and that he would presumably have preferred to have the whole trust fail if the particular purpose is impossible of accomplishment. In such a case the cy pres doctrine is not applicable.

4 A. SCOTT, LAW OF TRUSTS § 399, at 3085 (3d ed. 1967).

[11] GA. CODE ANN. § 108-106(4) (1959) provides:

Where a trust is expressly created, but no uses are declared, or extend only to a part of the estate, or fail from any cause, a resulting trust is implied for the benefit of the grantor, or testator, or his heirs.

[12] 224 Ga. 826, 165 S.E.2d 160 (1968).

[13] Evans v. Abney, 396 U.S. 435 (1970).

[14] *See, e.g.*, Local 590, Food Employees Union v. Logan Valley Plaza, Inc., 391 U.S. 308 (1968) (state delegating power to owners of shopping center by permitting them to use trespass laws to prohibit exercise of first amendment rights); Reitman v. Mulkey, 387 U.S. 369 (1967) (amendment to state constitution giving racial discrimination in housing a preferred position in the law); Robinson v. Florida, 378 U.S. 153 (1964) (existence of a manual of the state board of health embodying state policy of putting burdens on restaurants serving both blacks and whites sufficient to preclude conviction of sit-in demonstrators for trespass); Burton v. Wilmington Parking Authority, 365 U.S. 715 (1961) (discrimination by lessee of state property attributed to state's failure to require nondiscrimination, making state significantly involved in the discrimination).

[15] 334 U.S. 1 (1948).

by private citizens to effect a sort of racial zoning that was so widespread non-Caucasians were effectively being denied the opportunity to buy or rent most of the desirable residential property in the country.[16] Since it had been decided[17] that states could not use racial zoning without infringing the fourteenth amendment and the Civil Rights Act of 1866,[18] and because the *Civil Rights Cases*[19] had established that the fourteenth amendment proscribed only state action and did not speak to private acts, the Court in *Shelley* was faced with a real dilemma. It was the power of the states operating through their judiciaries that made the discrimination work; yet the discriminatory motivation came from private citizens. The Court's solution was to combine the two earlier rulings into a holding that, because they were between private parties, the racially restrictive covenants themselves were constitutionally permissible but "that in granting judicial enforcement of the restrictive agreements in these cases, the states [had] denied [the] petitioners the equal protection of the laws."[20] Five years later the Court expanded that ruling by holding in *Barrows v. Jackson*[21] that one who breached a racial covenant could not be required to answer in damages to his co-covenantor for the breach because it would amount to using the coercive power of the state to compel, indirectly, compliance with a covenant that was unenforceable directly.

Taken together *Shelley* and *Barrows* could be read to support the proposition that any time an individual uses the power of the state courts to effect a discriminatory purpose the fourteenth amendment has been violated;[22] however the cases themselves had not gone that far, and it was unclear how far they might be expanded. Nor has any direct answer been received because the Court has not since *Barrows* relied substantially on *Shelley*.[23] This has not been due to any lack of cases presenting prob-

[16] *See* C. VOSE, CAUCASIANS ONLY (1959).

[17] Buchanan v. Warley, 245 U.S. 60 (1917).

[18] Act of Apr. 9, 1866, ch. 31, § 1, 14 Stat. 27 now embodied in 42 U.S.C. § 1982 (1964).

[19] 109 U.S. 3, 11 (1883).

[20] 334 U.S. 1, 20 (1948). That judicial action was state action capable of infringing the fourteenth amendment had been decided in *Ex parte* Virginia, 100 U.S. 339, 347 (1879). *Shelley* was novel because the discrimination originated with the private litigants but was attributed to the court.

[21] 346 U.S. 249 (1953).

[22] One early commenator felt *Shelley* alone established that "no determination [by a state court] of a relationship which may vary with the race of the persons involved will satisfy [the] requirements [of the fourteenth amendment]." Ming, *Racial Restrictions and the Fourteenth Amendment: The Restrictive Covenant Cases*, 16 U. CHI. L. REV. 203, 234 (1949).

[23] *Shelley* has been cited by the Court with some frequency to support minor

lems susceptible to being resolved on the basis of *Shelley* but because the Court has either denied certiorari[24] or handled the cases it has heard in such a way that the scope of *Shelley* has become more uncertain.[25]

One year after *Barrows* the Court split evenly over the constitutionality of a state court's action permitting a cemetery company to rely on a Caucasians-only clause of a contract as a defense in an action for breach of contract.[26] The cemetery had refused to inter the remains of the plaintiff's husband because he was an American Indian. The following term the Court held, without mentioning *Shelley*, that a state court decision that membership in the Communist Party constituted just cause for discharge under an employment contract did not raise a federal question;[27] three members of the Court felt *Shelley* compelled a reversal.[28]

The Court's failure to clarify the scope of *Shelley* provoked various proposals by commentators as to its real meaning. Professor Pollak submitted that the underlying principle was that the state may not assist "a private person in seeing to it that others behave in a fashion which the state itself could not have ordained."[29] Others suggested *Shelley* be confined to cases in which the impact of the discrimination is so broad as to take on the aspects of a governmental function[30] using the rationale of *Marsh v. Alabama*[31] and the white primary decisions.[32] Another com-

points. *E.g.*, Cooper v. Aaron, 358 U.S. 1, 17 (1958) (citing *Shelley* for the proposition that fourteenth amendment applies to action of state judiciary). *But see* Kreshik v. Saint Nicholas Cathedral, 363 U.S. 190 (1960) (per curiam) (involving power of state court to determine rights of competing factions of religious group).

[24] *E.g.*, Gordon v. Gordon, 332 Mass. 197, 124 N.E.2d 228 (1955), *cert. denied*, 349 U.S. 947 (1955) (judicial enforcement of will provision revoking gift to child for marrying person not born to Jewish faith not violative of the fourteenth amendment); Charlotte Park & Rec. Comm'n v. Barringer, 242 N.C. 311, 88 S.E.2d 114 (1955), *cert. denied*, 350 U.S. 983 (1956) (holding *Shelley* did not prevent reversion of property donated to city for use as park for whites only, because reversion would occur without the aid of the court if Negroes were permitted to use the facility).

[25] *E.g.*, Rice v. Sioux City Memorial Park Cemetery, Inc., 349 U.S. 70 (1955); Black v. Cutter Laboratories, 351 U.S. 292 (1956); cases cited note 34 *infra*.

[26] Rice v. Sioux City Memorial Park Cemetery, Inc., 348 U.S. 880 (1954). The Court reheard the case the next term but dismissed the writ of certiorari as improvidently granted noting that a recent act of the state legislature would preclude a further occurrence in that jurisdiction. 349 U.S. 70 (1955).

[27] Black v. Cutter Laboratories, 351 U.S. 292 (1956).

[28] *Id.* at 302.

[29] Pollak, *Racial Discrimination and Judicial Integrity*, 108 U. PA. L. REV. 1, 13 (1959).

[30] Lewis, *The Meaning of State Action*, 60 COLUM. L. REV. 1083, 1108-1120 (1960).

[31] 326 U.S. 501 (1946) (owner of company town acting so much like agency of

mentator argued that it be viewed as a general prohibition of state enforcement of private discrimination that the state itself could not require, but that exceptions should be made where the discriminator has a competing claim of basic rights which outweighs the victim's claim to equal protection.[33]

In the early sixties the advent of the civil rights sit-in demonstration with its subsequent arrests and convictions for violation of trespass statutes seemed to provide the ideal vehicle for clarifying *Shelley*. The Court however chose to avoid the *Shelley* question and decide the cases on other grounds.[34] The thoroughness with which the issue was avoided is indicated by the fact that *Shelley* was not once mentioned in a majority opinion though it appears in both dissenting[35] and concurring[36] opinions as well as briefs of counsel.[37] This prompted one writer[38] to announce that Professor Wechsler had been right when he characterized *Shelley* as

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the state that it may not use force of state trespass laws to abridge first amendment rights in manner forbidden to state).

[33] *E.g.*, Smith v. Allwright, 321 U.S. 649 (1944) (exclusion of Negroes by Democratic Party prevented them from participating in primary and violated fifteenth amendment because primary was part of machinery for choosing elected officials); Terry v. Adams, 345 U.S. 461 (1953) (unofficial private primary which excluded Negroes and effectively determined who officeholders would be violated fifteenth amendment).

[33] An illustration of this position would be where a homeowner has a trespasser prosecuted and concedes that his only reason for doing so was the race of the trespasser.

> Even when one excludes on the basis of race, the state which helps give effect to the exclusion is implementing a general, basic, proprietary right, reaching far back into and behind the common law; the enforcement of discrimination is incidental. The victim of such discrimination, on the other hand, suffers a minor limitation and a limited and unpublic indignity.

Henkin, *Shelley v. Kraemer: Notes for a Revised Opinion*, 110 U. PA. L. REV. 473, 498 (1962).

[34] *See, e.g.*, Bouie v. City of Columbia, 378 U.S. 347 (1964) (trespass statute did not give fair notice that refusing to leave after being requested to do so was prohibited); Bell v. Maryland, 378 U.S. 226 (1964) (reversed and remanded so state court could determine whether state law required dismissal of the charge because legislation enacted subsequently made defendants' conduct lawful); Peterson v. City of Greenville, 373 U.S. 244 (1963) (discriminatory action attributed to state because local ordinance compelled segregation in eating facilities); Lombard v. Louisiana, 373 U.S. 267 (1963) (discriminatory action attributed to state because statements by local officials that sit-ins would not be tolerated was form of compulsion).

[35] Bell v. Maryland, 378 U.S. 226, 328 (1964) (Black, J., dissenting).

[36] Lombard v. Louisiana, 373 U.S. 267, 278 (1963) (Douglas, J., concurring).

[37] *E.g.*, Petitioner's Brief for Certiorari at 8, Bell v. Maryland, 378 U.S. 226 (1964).

[38] Paulsen, *The Sit-in Cases of 1964: "But Answer Came There None,"* 1964 SUP. CT. REV. 137, 151.

an ad hoc decision "yielding no neutral principles for [its] extension or support."[39]

Evans v. Abney provided the Court with yet another opportunity to update the status of *Shelley* since the strongest arguments for preventing the reversion were based on *Shelley*.[40] Mr. Justice Brennan in his dissenting opinion in *Abney* stated that *Shelley* "stands at least for the proposition that where parties of different races are willing to deal with one another a state court cannot keep them from doing so by enforcing a privately authored racial restriction."[41] This is very close to Professor Pollak's interpretation of *Shelley*[42] and can be easily applied to the facts in *Abney*. The testator was the sole author of the racial restrictions, not the state. The litigation was commenced because the trustees under the will had allowed non-whites to use the park.[43] Thus it is apparent that the trustees were prepared to deal with those discriminated against by the terms of the will, and it is clear from the intervention of the local Negroes that they wished to use the park. Although the attempt to enforce specifically the racial provisions of the will was defeated by *Evans v. Newton*,[44] *Abney* enforces them indirectly. The title and right to use the property turns on the color of the prospective users and yields a more extreme result than the normal restrictive covenant case because here, those who are clearly entitled to use the property under the terms of the will are divested of that right. This divestiture in effect punishes Macon for not enforcing the discriminatory provisions of the will and encourages others similarly situated to enforce such restrictions for as long as possible;[45] thus the

[39] Wechsler, *Toward Neutral Principles of Constitutional Law*, 73 HARV. L. REV. 1, 31 (1959).

[40] Two other major arguments were thought by Justice Brennan to require reversal. One was based on the inability of a state to accept a gift with unconstitutional restrictions, and the other was based on the idea that if a state gives racial discrimination a preferred status in its laws the fourteenth amendment is violated. 396 U.S. 435, 455-59 (1970).

[41] *Id.* at 456.

[42] Pollak, *Racial Discrimination and Judicial Integrity*, 108 U. PA. L. REV. 1, 13 (1959).

[43] Even though the trustees under the will had resigned and had been replaced it is apparent that they did so not out of hostility to the admission of non-whites but out of fear the property would revert to the heirs if it were not operated on a segregated basis. 396 U.S. at 456.

[44] 382 U.S. 296 (1966).

[45] That such a result is not entirely conjectural is illustrated by litigation involving Tanglewood Park near Winston-Salem, N.C. There a testator had devised his sizeable home and grounds to private trustees to be used as a public park for whites only. Since the park included various facilities of public accommodation, the trustees brought an action for declaratory judgment in a state court to deter-

coercive power of the state is used to compel and encourage parties of different races not to deal with each other in good faith.

In *Bell v. Maryland*[46] Mr. Justice Black, in his dissenting opinion, sought to show that a crucial element in *Shelley* was the existence of a federally protected right to own property in addition to the equal protection demands of the Constitution. This interpretation would seem to apply to *Abney* in which enforcement of the restriction would interfere with a federally protected right of access to public facilities.[47] Nor is it very convincing to say that in this case there is a competing basic right—the right of a donor to place conditions on charitable gifts—which outweighs the equal protection claims of the petitioners, since it is clear that such conditions can be, and are frequently, subject to numerous restrictions.[48]

However Justice Black, writing for the majority in *Abney*, says that *Shelley* is easily distinguishable because it prohibited judicial action affirmatively enforcing a private scheme of discrimination against Negroes whereas here the discrimination against Negroes is eliminated by eliminating the park. This distinction would be more meaningful had not *Shelley* been supplemented by *Barrows* in which the Court prohibited indirect enforcement of restrictive covenants by penalizing the party who failed to comply with the covenant. The Court answers that argument, though without specifically referring to *Barrows*, by saying "that the will of Senator Bacon and Georgia law provide all the justification neces-

mine whether, in light of the public accommodations provisions of the Civil Rights Act of 1964, 42 U.S.C. § 2000a (1964), they could permit Negroes to use the facilities. The state court held that the intent of the testator was to exclude Negroes and to admit them would cause the property to vest in alternate beneficiaries of the will; therefore, the court ordered the trustees to take whatever steps necessary to operate the park on a segregated basis for as long as possible. Lybrook v. City of Winston-Salem, Forsyth County Super. Ct. (Nov. 5, 1964). The trustees thereupon closed various facilities at the park to keep it beyond the reach of the statute until May 3, 1968 when an action was brought by the United States to compel the integration of the park. The court found that the park was covered by the statute and enjoined the trustees from continuing to operate it on a segregated basis. United States v. The William & Kate B. Reynolds Memorial Park, Inc., Civil No. C-62-WS-68 (M.D.N.C. Mar. 11, 1970). The state court then held that the inability of the trustees to comply with the terms of the trust had caused the alternate dispositons to take effect. However the court approved an arrangement by the trustees and alternate beneficiary to lease the park to a non-profit corporation that would operate it on an integrated basis. Lybrook v. Winston-Salem, Forsyth County Super. Ct. (Apr. 13, 1970).

[46] 378 U.S. 226, 328 (1964).

[47] *See* 42 U.S.C. § 2000b (1964).

[48] *See, e.g.*, 4 A. SCOTT, LAW OF TRUSTS § 410, at 3174 (3d ed. 1967).

sary for imposing such a 'penalty'."[49] A similar statement could have also been made in *Barrows* but there the Court, looking beyond the contractual relationship of the parties, realized that the effect of allowing the penalty would be to undermine the effectiveness of *Shelley*. In *Abney* the Court does not appear to be concerned about the ultimate effect of the penalty, probably because the greatest distinction between *Shelley* and the problem here is one of size or degree. There is little reason to believe that permitting the reversion in this case will result in the widespread deprivation of federally protected civil rights that would have resulted from the opposite decision in *Shelley*.[50] This being so, Professor Lewis' view of *Shelley* as really being a problem of delegation of the authority of the state[51] can be more easily reconciled with *Abney* than can most others. The result is that *Shelley* in all probability can no longer be used to support the proposition that state action, violative of the fourteenth amendment, results whenever state courts are used by private parties to discriminate against others in ways the state could not itself have used.[52] As Justice Black said:

> Surely the Fourteenth Amendment is not violated where, as here, a state court operating in its judicial capacity fairly applies its normal principles of construction to determine the testator's true intent in establishing a charitable trust and then reaches a conclusion with regard to that intent which, because of the operation of neutral and nondisciminatory state trust laws, effectively denies everyone, whites as well as Negroes, the benefits of the trust.[53]

It seems that the Court has long felt uneasy with *Shelley* to the extent that it attributes to the courts the motivations of the litigants and this case appears to move away from that position, or at least declines to

[49] 396 U.S. 435, 444 (1970).

[50] C. VOSE, *supra* note 16.

[51] Lewis, *The Meaning of State Action*, 60 COLUM. L. REV. 1083, 1115-20 (1960). As Professor Lewis noted the opinion of the Court did not approach *Shelley* in this manner. This approach moreover is so substantially different from that of the Court that its acceptance destroys *Shelley* as it has been traditionally viewed.

[52] If viewed as being a means to an end *Shelley* is no longer necessary on its own facts since the discovery by the Court that 42 U.S.C. § 1982 (1964) applies to individual as well as state action. Jones v. Alfred H. Mayer Co., 392 U.S. 409 (1968). 42 U.S.C. § 1982 (1964) provides:

> All citizens of the United States shall have the same right in every State and Territory, as is enjoyed by the white citizens thereof to inherit, purchase, lease, sell, hold, and convey real and personal property.

[53] 396 U.S. 435, 446 (1970).

extend it. It is significant that, from the many arguments presented by the petitioners,[54] the Court chose to reply to three relatively minor arguments that related to the racial neutrality of the courts because the replies underscore the Court's distaste for attributing the racial prejudices of the testator to the courts responsible for supervising the disposition of his property.[55] This may be indicative of a changing attitude of the Court which will tend to give the equal protection clause a rest while relying more on legislation to eliminate racial discrimination. Recent civil rights legislation[56] certainly makes this feasible.

GEORGE S. KING, JR.

Insurance—Judicial Construction of the Lender's Policy of Title Insurance

The recent trend of judicial interpretation of standard insurance policies has been to construe policies liberally in order to provide more comprehensive coverage for the insured. Although the courts have depended upon various principles of contract interpretation to accomplish this end, the import of adjudication in this field reveals a sound propensity of the courts to protect the consumer. The brunt of the criticisms of insurance practices has recently fallen upon the underwriters of liability insurance. However, a recent case, *Paramount Property Co. v. Transamerica Title Insurance Co.*,[1] expands the criticisms of liability insurance policies to encompass the provisions of the standard lender's policy of title

[54] In their . . . briefs, the petitioners . . . have advanced several arguments which we have not here discussed. We have carefully examined each of these arguments, however, and find all to be without merit.
396 U.S. 435, 448 (1970).

[55] To the contention that the Georgia courts had violated the Constitution by making the "anti-Negro choice" with regard to the uncertain intent of the testator, the Court replied that there was no constitutional obligation to resolve doubts in favor in of integration. To the argument that the decision the trust had failed rested on a premise by the court that integration would destroy the desirability of the park to whites, the Court said that it was the desirability of integration to the testator alone that caused the trust to fail. In response to the prediction of loss to the public of many charitable trusts, the Court pointed out that state courts were free to use or not use cy pres as they normally would. 396 U.S. 435, 445-47 (1970).

[56] *E.g.*, Civil Rights Act of 1968, tit. VIII, 42 U.S.C. §§ 3601-3619 (Supp. V, 1970); Civil Rights Act of 1964, 78 Stat. 241 (codified in scattered sections of 5, 28 & 42 U.S.C.).

[1] 1 Cal. 3d 562, 463 P.2d 746, 83 Cal. Rptr. 394 (1970) (in bank). *Paramount* relies heavily upon a recent case construing a liability insurance policy. Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966) (in bank).

insurance.[2] Although the disposition of the particular fact situation involved is essentially just, the express and implied analogies that the court has drawn between the principles underlying the two types of insurance are not altogether accurate; thus, specific aspects of the decision necessitate further clarification.

The facts of the case succinctly illustrate the nature of title insurance for the lender, as well as depict problems of interpretation that may arise in even a relatively straight-forward, standardized contract. The defendant title insurance company had issued two standard lender's policies to the plaintiff, Paramount Property Co., one for each of two deeds of trust that had been delivered to Paramount by third parties to secure a loan. Subsequently, one Guibbini, alleging ownership of the land, filed a quiet title action declaring that the deeds of trust were invalid. During the pendency of the suit, which the title insurance company defended in accord with its obligation,[3] Guibbini paid Paramount the amount of the indebtedness due, received a reconveyance of the trust deeds, and dismissed his action without prejudice. This transaction enabled Guibbini to clear record title to the parcels of land in preparation for their sale. After selling one parcel, Guibbini commenced a new action, only two months after the first, to recover the amount paid. He claimed that Paramount's lien was invalid on the identical grounds stated in the previous action, and, in addition, he contended that he paid the debt under duress,—that Paramount knew or should have known of the invalid lien but, realizing that Guibbini could not sell the property until he removed the cloud on the title, continued to assert its claim. The title insurance company, standing by the explicit terms of the policies, declined to defend in Guibbini's second suit. Paramount successfully defended this action and thereafter brought suit against the title insurance company for reimbursement of the costs of the defense.

Paramount's action against the title insurance company raised the issue of the proper construction of several provisions of the standard lender's policy of title insurance.[4] The standard policy contained the following termination clause: "*Payment in full by any person* or voluntary satisfaction or release by the Insured of a mortgage covered by this policy shall terminate all liability of the company to the insured owner of the

[2] 1 Cal. 3d at 566 nn.2 & 3, 570 n.6, 463 P.2d at 748 nn.2 & 3, 751 n.6, 83 Cal. Rptr. at 396 nn.2 & 3, 399 n.6. These provisions are those of the AMERICAN LAND TITLE ASSOCIATION [hereinafter cited as ALTA] MORTGAGEE POLICY 1962 (Rev. 1968 & 1969) paras. 4(a), 7(d) & 3(d).

[3] 1 Cal. 3d at 566 n.2, 463 P.2d at 748 n.2, 83 Cal. Rptr. at 395 n.2.

[4] *Id.* at 565, 463 P.2d at 747, 83 Cal. Rptr. at 395.

indebtedness secured by such mortgage . . . ."[5] The policy also excluded from coverage "[d]efects known to the insured either at the date of this policy or at the date such insured acquired an . . . interest insured by this policy . . . ."[6] Relying on these two clauses, the title insurance company offered two basic defenses: First, since there had been a "payment in full" according to the unambiguous language of the policy, the coverage had terminated. Second, even if the policy were in full effect, Guibbini's complaint alleged that Paramount knew or should have known that the title was defective, thus bringing the case within the latter mentioned exclusion from coverage. The court of appeals found no ambiguity in the termination clause and adjudged that the policy had terminated;[7] the California Supreme Court, in reversing, decided that the policy had not terminated and that the title insurance company did have a duty to defend.

In resolving this first issue of the case, the court found that the accepted practice of paying a debt in full to remove a cloud on the title and immediately suing for a refund[8] did not constitute a payment in full as was contemplated by the parties to the contract.[9] The court conceded that in most circumstances the termination clause would operate in a straightforward manner, but the unique situation at bar created an ambiguity in the clause in light of the purpose of the contract[10] and the reasonable expectations of the parties.[11] Thus the court ruled that only a final and unconditional payment should be considered a "payment in full." By

[5] ALTA MORTGAGEE POLICY para. 7(d) (emphasis added).

[6] *Id.* at para. 3(d).

[7] Paramount Prop. Co. v. Transamerica Title Ins. Co., 77 Cal. Rptr. 894 (Cal. Ct. App. 1969).

[8] *See* Leeper v. Beltrami, 53 Cal. 2d 195, 347 P.2d 12, 1 Cal. Rptr. 12 (1959).

[9] 1 Cal. 3d at 567-69, 463 P.2d at 749-50, 83 Cal. Rptr. at 397-98.

[10] The purpose of title insurance is to protect the insured from loss growing out of an undiscovered defect in title to the insured property. 1 Cal. 3d at 568, 463 P.2d at 750, 83 Cal. Rptr. at 398. The statutes of many states reflect this definition, *e.g.*, N.C. GEN. STAT. § 58-132 (1965). For comparable definitions *see* J. MAGEE & D. BICKELHAUPT, GENERAL INSURANCE 548 (7th ed. 1964); Johnstone, *Title Insurance*, 66 YALE L.J. 492 (1957).

[11] 1 Cal. 3d at 568, 463 P.2d at 750, 83 Cal. Rptr. at 398; *see, e.g.*, Harris v. State Farm Mut. Ins. Co., 232 F.2d 532, 536 (6th Cir. 1956); Boeing Airplane Co. v. Firemen's Fund Indem. Co., 44 Wash. 2d 488, 268 P.2d 654 (1954); 3 A. CORBIN, CONTRACTS § 545, at 164 (1960); 1 RESTATEMENT OF CONTRACTS § 236(b) (1932). The rules established for the construction of written contracts are also applicable to policies of insurance. *See generally* 43 AM. JUR. 2d *Insurance* § 257 (1969). Since a title insurance policy is a contract of insurance rather than a suretyship, rules of contract interpretation apply. *See* DeCarli v. O'Brien, 150 Ore. 35, 41 P.2d 411 (1935); Foehrenbach v. German-American Title & Trust Co., 217 Pa. 331, 66 A. 561 (1907).

purporting to discern the reasonable expectations of parties to a contract under the particular circumstances involved, the court has, in effect, implemented a policy of protection for the insured. Nevertheless, to augment the impact of this decision on future cases that may call upon the courts to construe any provision of the standard lender's policy of title insurance, the court reinforced its reasoning with the established principle that ambiguous insurance contracts are to be resolved against the insurer.[12] However, except for the reference to the ambiguities involved in the contract, the court did not illuminate the rationale behind this principle nor explain its applicability to the case. Basic contract law provides that where language is ambiguous it will be construed against the party who drafted it.[13] The insurer almost always provides the contract, but because the insurer has the further advantage of being, in most situations, the stronger party in a setting of extreme disparity of bargaining power, the courts have perceived a contract of adhesion[14] and have found for the insured upon observation of the slightest ambiguity in language, or the comparatively small size of print or the location of certain provisions.[15] The courts advocating the doctrine have come dangerously close to writing a contract for the parties, but they have recognized that, in reality, the insurance company is a highly professionalized institution[16] issuing a standardized, technically phrased contract on a take-it-or-leave-it basis which is rarely, if ever, understood by the layman who pays the premium.[17]

Notwithstanding the magnanimous intentions of the courts, one might

[12] 1 Cal. 3d at 570, 363 P.2d at 750, 83 Cal. Rptr. at 398.

[13] *See* 4 S. WILLISTON, CONTRACTS § 621, at 760 (Jaeger ed. 1961).

[14] When the stronger party drafts the contract, ambiguities will be construed in favor of the weaker party. See Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833, 855-61 (1964); *see also* Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943). The basis of the doctrine of contracts of adhesion is suggested by Isaacs, *The Standardizing of Contracts*, 27 YALE L.J. 34 (1917). *See, e.g.*, Aschenbrenner v. United States Fid. & Guar. Co., 292 U.S. 80, 84-85 (1934); First Nat'l Bank v. United States Fid. & Guar. Co., 416 F.2d 52, 56 (5th Cir. 1969).

[15] *E.g.*, Steven v. Fidelity & Cas. Co., 58 Cal. 2d 862, 878, 377 P.2d 284, 294, 27 Cal. Rptr. 172, 182 (1962): "If [the insurer] deals with the public upon a mass basis, the notice of non-coverage of the policy, in a situation in which the public may reasonably expect coverage, must be conspicuous, plain, and clear." *Cf.* Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960). *See also* UNIFORM COMMERCIAL CODE § 2-302.

[16] The insurance company is obviously more highly skilled in the field than the layman. See 7A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4687 (1962).

[17] *E.g.*, Coniglio v. Connecticut Fire Ins. Co., 180 Cal. 596, 599, 182 P. 275, 276 (1919).

reasonably argue that the doctrine of contracts of adhesion should not be applied to the standard lender's policy of title insurance.[18] An explanation of the origins and subsequent development of the ALTA Loan Policy offers a point of departure for such an argument. The real estate boom in the United States after World War I provided a lucrative outlet for life insurance companies eager to invest their funds, and since they were obligated to go to the land, these companies expanded their operations far from home localities. To protect their investments against loss from defects in title they required broad insurance coverage and, because of the diverse insurance practices throughout the nation, a standard policy.[19] In response to this demand, four large life insurance companies drafted the Life Insurance Company Standard Loan Policy (L.I.C. Policy).[20] In 1929 the American Title Association (now the American Land Title Association) in concert with the four life insurance companies responsible for the L.I.C. Policy, drafted a standard lender's policy of title insurance which incorporated the elements of the L.I.C. Policy.[21] The ATA immediately prepared to present its standard policy to all life insurance companies lending money on first mortgages, as well as to all real estate mortgage companies in general.[22] That the individual title insurance company should adopt the form was assumed: "The Association is going to exert every effort to secure its adoption and requests for its use from the loaning agencies, and trusts that every title company will immediately adopt and put into use as their sole mortgagee's form."[23]

It is interesting to note that the size of the print and the general form of the first ALTA policy compare closely to those aspects in the recent ALTA Loan Policy which were criticized by the court in *Paramount*. Also included in the policy of 1929 was the provision contained in the present policy regarding termination of insurer's liability upon payment in full or release by the insured. It is true that the title insurance industry largely owes its expansion in recent years to the institutional lenders,[24]

[18] *See* Johnstone, *Title Insurance*, 66 YALE L.J. 492, 504-05 (1957).

[19] Henley, *What Investors in Mortgage Loans Are Demanding in Title Insurance*, 35 TITLE NEWS, May, 1956, at 12.

[20] Metropolitan Life Insurance Company, Prudential Insurance Company, Equitable Life Assurance Society of the United States, and John Hancock Mutual Life Insurance Company. *See The American Land Title Association Standard Loan Policy of Title Insurance*, 8 TITLE NEWS, July, 1929, at 5.

[21] 8 TITLE NEWS, July, 1929, at 5.

[22] *Id.*

[23] *Id.* at 10.

[24] Glendining, *Title Insurance in Massachusetts*, 3 BOST. B.J., April, 1959, at 21.

but, in turn, the lenders have continued to demand active participation with the ALTA in the revisions of the standard lender's policy and to push for maximum coverage.[25] The title insurance industry has, with some consternation, been cognizant of these efforts.[26]

There is, of course, no precise answer to the question of whether the policy of title insurance for the lender should be viewed as a contract of adhesion[27] in the same manner as, for example, the liability insurance contract. However, the cursory analysis of the court should be clarified to determine the impact of its decision on future construction of the policies. The provisions of the ALTA Loan Policy have been written into the policies of almost every title insurance company in the United States.[28] It would seem unjust to rely on a blanket application of the rule that an insurance contract is resolved aganist the insurer when the insurer may not have a bargaining position superior to the insured, and when the form contract in question is not fully written nor developed by the insurer. It is true that the above rule has been generally applied in the construction of insurance contracts, title insurance policies included, but most courts have stipulated that the rule is applicable because the insurer alone drafts the policy and presents it to a consumer who has no choice but to accept it.[29] Furthermore, the insured lending institution is a member of a powerful industry and is hardly in the same weak position as the individual consumer.[30]

The second basic question resolved in *Paramount* is whether or not the

[25] *E.g.*, Henley, *Report of Chairman, Committee on Title Insurance Standard Forms*, 40 TITLE NEWS, Jan., 1961, at 130; *see also* Schuenke, *What a Life Insurance Company Requires . . .*, 48 TITLE NEWS, Mar., 1969, at 18.

[26] Henley, *supra* note 19.

[27] In contrast to the ALTA Loan Policy, the ALTA Owner's Policy seems more analogous to a contract of adhesion. For example, the lender's policy, basically a rewritten L.I.C. Policy, was drafted before the owner's policy. Insurance rates are also lower for the lender than for the owner. Although the difference in rates exists partly because the risk terminates more quickly for the lender, the risk for the lender decreases as the debt is paid, and, in the case of the lender, the insurer has a chance to salvage losses through debt assignment. One authority attributes the difference to the greater bargaining power of the lender. Johnstone, *supra* note 18, at 504. Finally, the coverage for the owner is slightly less than for the lender.

[28] Johnstone, *supra* note 18, at 504.

[29] *E.g.*, Liberty Mut. Ins. Co .v. Hercules Powder Co., 224 F.2d 293, 294 (3d Cir. 1955); Heffron v. Jersey Ins. Co., 144 F. Supp. 5, 9 (E.D.S.C. 1956); Gould Morris Elec. Co. v. Atlantic Fire Ins. Co., 229 N.C. 518, 520, 50 S.E.2d 295, 297 (1948); Marandino v. Lawyers' Title Ins. Corp., 156 Va. 696, 700, 159 S.E. 181, 182 (1931).

[30] *Cf.* Navin, *Waiver of Defense Clauses in Consumer Contracts*, 48 N.C.L. REV. 505, 524-25 (1970).

title insurance company had a duty to defend under a policy in full effect. The court understandably had little difficulty finding that the title insurance company had violated its duty to defend in light of a recent and important California case, *Gray v. Zurich Insurance Co.*,[31] which made this duty absolute in the field of liability insurance. Before *Gray*, the duty to defend was generally determined by the allegations of the complaining party.[32] The title company in *Paramount* apparently adhered to this position, and the underlying issue of both *Gray* and *Paramount* is identical —in both cases the complaints of the third parties alleged intentional acts excluded from coverage by the policies. The court in *Gray* held that the allegations of the complaint are not determinative of the duty to defend since, under the modern rules of civil procedure, the facts of the case are stressed rather than the theory of recovery set forth in the complaint.[33] Therefore, as long as there remains a reasonable potential of liability, the insurer is obligated to defend. In *Gray* the doctrine of contracts of adhesion provided the primary support for this position. The liability insurance policy in *Gray*, as do most liability insurance policies, contained the following provision in the insuring clause: "[T]he company shall defend any suit against the insured . . . even if any of the allegations of the suit are groundless, false, or fraudulent."[34] The court construed this opening, broad promise to defend to be incompatible with the less conspicuous exclusion from coverage of an intentional act on the part of the insured, and the ambiguity was resolved, according to the established rule, in favor of the insured. The court in *Paramount* justified its holding by relying on *Gray's* reference to the modern rules of civil procedure and by supporting this reiteration of *Gray* with a simple analysis of the facts involved.[35] Nevertheless, by an almost dogmatic reliance upon *Gray* with respect to the above issue, the court has at least opened the door for future decisions to extend the duty to defend under a standard policy of title insurance where the claim against the insured alleges facts more clearly outside express terms of the policy. Modern rules of civil procedure alone may warrant such decisions, but the ALTA

[31] 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966) (in bank).

[32] *See* 7A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4683 (1962); Annot., 50 A.L.R.2d 458, 465, 497 (1956).

[33] 65 Cal. 2d at 276-77, 419 P.2d at 176-77, 54 Cal. Rptr. at 112-13. *See* F. JAMES, CIVIL PROCEDURE § 2.11, at 85-86 (1965).

[34] 65 Cal. 2d at 267, 419 P.2d at 170, 54 Cal. Rptr. at 106.

[35] Since the complaint of Guibbini did not say *when* Paramount knew or should have known of the invalid lien, the facts alleged may possibly fall within the terms of the policy. *See* ALTA LOAN POLICY para. 3(d).

policy does not contain the broad and ambiguous promise to defend, heavily relied upon by *Gray*, nor does the doctrine of contracts of adhesion apply without question to the lender's policy.

The ALTA has been aware of judicial criticisms of insurance policies, and the recently drafted ALTA Policies of 1970, the Owner's Policies (Forms A and B), the Loan Policy, and the new Single Form Policy reflect an attempt to anticipate these criticisms. The revisions attempt to clarify possible ambiguities in the form of the policies, rather than limit coverage. All the policies expand and make more conspicuous the insuring clauses to include immediately reference to the exclusions from coverage. The purpose behind this revision is to thwart the possible judicial ruling that the fine print of an exlusionary clause is inconsistent with the bold print promising to insure, with the result that the exclusionary clause is ignored.[36] The 1970 ALTA Loan Policy and the 1970 Single Form Policy continue to contain the provision terminating the insurer's liability when there is payment in full[37] but the provision is under the subheading "Reduction of Liability" rather than under the subheading found to be ambiguous in *Paramount*, "Payment of Loss."[38] The 1970 ALTA Policies generally define the purpose and the scope of the coverage with more exactness. At any rate, the scope of the coverage as well as the form of the policy of title insurance for the lender are not controlled by the individual title insurance companies to the extent that a court should mechanically resolve ambiguities it might find in even revised policies in favor of the lending institution.

CHRISTIAN NESS

Labor Law—The Right to an Unbiased Tribunal in Union Disciplinary Proceedings

A significant weakness in union disciplinary procedure has been the

[36] All of the 1970 ALTA Policies contain as the first sentence of the policy the following provision: "SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS CONTAINED IN SCHEDULE B AND THE PROVISIONS OF THE CONDITIONS AND STIPULATIONS HEREOF . . . ."

[37] ALTA LOAN POLICY—1970 para. 8; ALTA SINGLE FORM POLICY—1970 para. 8.

[38] 1 Cal. 3d at 569-70, 363 P.2d at 571, 83 Cal. Rptr. at 399.

composition and operation of the "union tribunal."[1] At common law most courts required that a union member be given a "fair hearing" before serious disciplinary sanctions could be invoked,[2] with the majority rule being that a union member was entitled to a hearing whether provided for in the union's constitution or not.[3] By the enactment of the "Bill of Rights"[4] as part of the Labor-Management Reporting & Disclosure Act of 1959,[5] Congress codified the requirement of a "full and fair hearing," making it mandatory in all internal disciplinary procedures.[6] Choosing not to specify standards or even guidelines with respect to a full and fair hearing, Congress left it to the judiciary to hammer out the constituents.[7]

The "fair hearing" in labor law has generally embraced several elements closely resembling those of constitutional due process including full notice, the right to present evidence and to confront and cross examine witnesses. Another requisite of the full and fair hearing is that the accused be tried before an "impartial" tribunal.[8] For a variety of reasons the "unbiased" trial body has proved the most difficult of the due process requirements to attain. The failure stems both from dichotomous goals set by Congress and institutional peculiarities of labor unions themselves. While the "Bill of Rights" was envisioned as a body of law that would compel unions, when dealing with their own members, to follow democratic procedures, built into the legislation was the competing goal of developing

[1] Aaron, *The Labor-Management Reporting & Disclosure Act of 1959*, 73 HARV. L. REV. 851, 874 (1960).

[2] Parks v. International Bhd. of Elec. Workers, 314 F.2d 886 (4th Cir.), *cert. denied*, 372 U.S. 976 (1963).

[3] Comment, *Substantive and Procedural Due Process in Union Disciplinary Proceedings*, 3 U. SAN FRAN. L. REV. 389, 400 (1969).

[4] The Bill of Rights of Members of Labor Organizations, 29 U.S.C. § 411 (1964).

[5] Labor-Management Reporting & Disclosure Act of 1959, 29 U.S.C. §§ 401-02, 411-15, 431-40, 461-66, 481-83, 501-04, 521-31 (1964) (hereinafter cited as LMRDA).

[6] LMRDA § 101(a)(5), 29 U.S.C. § 411(a)(5) (1964) provides:

> No member of any labor organization may be fined, suspended, expelled, or otherwise disciplined except for nonpayment of dues by such organization or by any officer thereof unless such member has been (A) served with written specific charges; (B) given a reasonable time to prepare his defense; (C) afforded a full and fair hearing.

[7] Specific provision for a union member's access to the courts was made in LMRDA § 102, 29 U.S.C. § 412 (1964):

> Any person whose rights secured by the provisions of this subchapter have been infringed by any violation of this subchapter may bring a civil action in a district court of the United States for such relief (including injunctions) as may be appropriate.

[8] Parks v. International Bhd. of Elec. Workers, 314 F.2d 886, 912 (4th Cir. 1963).

strong, independent organs of self-government within unions so that governmental intervention would be minimal.[9] These worthy but sometimes conflicting objectives, combined with the institutional traits of the American union, have made it difficult for courts to delineate adequate standards for the unbiased trial.[10]

While there are a number of cases dealing with general due process standards as applied to disciplinary trials, very few deal directly with impartiality of the trial body per se. The Court of Appeals for the Third Circuit has recently decided an intra-union disciplinary case, *Falcone v. Dantinne*,[11] which bears directly on the "unbiased tribunal" issue. On Janaury 4, 1967, James Falcone, a member of the International Brotherhood of Boilermakers, Iron Ship Builders, Forgers & Helpers, Local Lodge 802, allegedly encouraged fellow members not to return to work at a dry dock company. He was also accused of harassing and physically threatening union officials.[12] Falcone was charged with violating three provisions of the union constitution[13] and then notified of the union's

[9] LMRDA § 101(a)(4), 29 U.S.C. § 411(a)(4) (1964) provides for exhaustion of internal remedies before a member may rely on the courts. It provides in part:

> No labor organization shall limit the right of any member thereof to institute an action in any court, or in a proceeding before any administrative agency, irrespective of whether or not the labor organization or its officers are named as defendants or respondents in such action or proceeding . . . *Provided*, That any such member be required to exhaust reasonable hearing procedures (but not to exceed a four-month lapse of time) within such organization, before instituting legal or administrative proceedings against such organizations or any officer thereof: . . . .

In a recent case the Third Circuit has described the objective of this section:

> The proviso . . . reflects an effort to encourage mature, democratic self government of labor organizations through the development of internal procedures for the correction of abuses by union officials and at the same time provide reasonably expeditious judicial relief to union members who have been denied the fundamental rights guaranteed by Title I of the LMRDA.

Harris v. International Longshoremen's Ass'n Local 1291, 321 F.2d 801 (3d Cir. 1963).

[10] *See, e.g.*, Summers, *The Law of Union Discipline: What the Courts Do in Fact*, 70 YALE L.J. 175, 200 (1960).

[11] 420 F.2d 1157 (3d Cir. 1969), *as amended on denial of rehearing* (1970).

[12] Falcone v. Dantinne, 288 F. Supp. 719, 722 (E.D. Pa. 1968), *rev'd*, 420 F.2d 1157 (3d Cir. 1970). These events took place after the union's officials had reached a "tentative" accord with management and had ordered the men to return to work. Falcone's defense was that the membership had mandated a strike unless a *firm* agreement was reached by January 4, 1967. *Id.* at 724-25.

[13] The specific provisions of art. XVII, § 1 of the constitution that Falcone was charged with violating are the following:

> (e) engaging in any activity or course of conduct detrimental to the welfare or best interest of the International Brotherhood or of a subordinate body;
>
> (k) engaging in or fomenting any acts or course of conduct which are inconsistent with the duties, obligations and fealty of the members of a trade

constitutionally required "informal hearing."[14] Attempts to reach agreement failed, necessitating a formal hearing before the trial body, a panel comprised of three officers, excluding charging or other directly involved parties, who were chosen by all of the elected officers.[15] All three of the members selected had attended and actively participated in the prior informal hearing.[16] The union's trial body heard the evidence, judged Falcone guilty and expelled him from the union for five years. On appeal to the international, the judgment was affirmed, but the punishment modified to five years suspension.[17]

Falcone sought an injunction in the district court[18] to prevent the union from depriving him of membership, the right to hold office or from any other union right. He argued that the union had violated the "fair hearing" provision of the LMRDA,[19] alleging that at least one of the members of the trial board had prejudged his guilt at the informal hearing.[20] He also asserted that the mere presence of the other two

union and which violate sound trade union principles or which constitute a breach of any existing collective bargaining agreement;

(m) threatening with violence or assaulting any union member or officer.

420 F.2d at 1159.

[14] A portion of art. XVII, § 2(b) provides:

After receiving . . . formal charges, the Local Lodge President or the International President, will within fourteen (14) days, set up an informal hearing between the parties directly involved and a sincere effort will be made to resolve the matter at this point.

420 F.2d at 1160.

[15] *Id.*

[16] Art. XVII, § 3(a) states that

[The] trial body of the Local Lodge shall consist of a panel of three of the elected officers of such lodge as decided by the elected officers. No charging or other directly involved parties shall sit as a member of the trial body, and any member of a trial body may be challenged for cause, and, if the trial body finds cause to exist, such member shall fill such vacancy by appointment. In the event such vacancy cannot be filled by a Local Lodge officer, the Local Lodge shall elect from among the members of the Local Lodge to fill such vacancy.

420 F.2d at 1161.

[17] 288 F. Supp. at 724. "Suspension" results in a temporary release of benefits and rights while "expulsion" results in a total surrender of the member's status—a severing of all connections between the member and the union. 420 F.2d at 1159 n.2. It has been observed that loss of membership can have disastrous repercussions including loss of one's job as well as loss of benefits accruing from retirement and medical plans. Comment, *Substantive and Procedural Due Process in Union Disciplinary Proceedings*, 3 U. SAN FRAN. L. REV. 389 (1969).

[18] See note 7 *supra.*

[19] This section guarantees a "full and fair hearing." See note 6 *supra.*

[20] Philip News, the chairman of the Trial Body, and one of the officers who participated in the informal hearing, made the following statement in response to Falcone's counsel in the district court:

members of the trial board at the informal hearing constituted bias.[21] The district court, finding no bias, affirmed the holding of the trial body and dismissed the complaint.[22] The court of appeals reversed and held that since one member of the trial board had prejudged the case, Falcone was not afforded the "full and fair hearing" guaranteed by the LMRDA.[23]

Falcone demonstrates the difficulties that courts have experienced in trying to infuse due process principles into the union trial apparatus. The court suggested two standards for combatting bias in union tribunals. Judge Stahl, writing for the court, reiterated what is the most prevalent standard among the judiciary—that specific bias must be proven before a court will overturn a union tribunal.[24] In an opinion concurring with the court's result, Judge Freedman posited a second standard:

> The circumstances themselves create the inherent impropriety . . . [I] disagree with the view which would require of an aggrieved party concrete proof of bias or prejudgment, because I think there is inherent in any participation in the informal hearing a disqualification against acting as a member of the Trial Body.[25]

> [During the informal hearing] [w]e asked Mr. Falcone to simply admit his guilt because it was obvious that it appeared by the evidence that he was guilty by all evidence possible, and that if he were to admit his guilt and save us all the necessity of a trial, of a hearing, that the penalty in all likelihood would be much lighter than possibly what it might be if we went to trial, went to hearing.

420 F.2d at 1161.

[21] 288 F. Supp. at 727. Falcone argued further that all of the witnesses against him were either union officers or related to union officers who were "predisposed" to a finding of guilt. *Id.* at 725.

[22] *Id.* at 728.

[23] 420 F.2d at 1167.

[24] 420 F.2d at 1160-61. The judge also stated:

> Nor do we see any inherent impropriety in having a union officer who attends and participates in the informal meeting subsequently sit as a member of the Trial Body and as a finder of fact at a formal hearing provided there is no element of bias or prejudgment.

Id. Judge Stahl explicitly recognized that Congress had left a void and that standards would have to be supplied (if at all) by the courts. To emphasize its point the court quoted from Highway Truck Drivers & Helpers Local 107 v. Cohen, 182 F. Supp. 608, 617 (E.D. Pa.), *aff'd per curiam*, 284 F.2d 162 (3d Cir. 1960), *cert. denied*, 365 U.S. 833 (1961) which referred to another section, § 501, of the same act:

> Congress made no attempt to "codify" the law in this area. It appears evident to us that they intended the federal courts to fashion a new federal labor law in this area, in much the same way that the federal courts have fashioned a new substantive law of collective bargaining contracts under § 301(a) of the Taft-Hartley Act. In undertaking this task the federal courts will necessarily rely heavily on the common law of the various states.

Id. at 1165 (citations omitted).

[25] 420 F.2d at 1168.

Freedman's opinion suggests that a showing of actual bias does not solve the fundamental problem of "inherent bias," a product of "the circumstances themselves." Implicit in his reasoning is the notion that unless courts can eradicate built-in, institutional bias, often hidden from view, it is a fallacy to believe that the judiciary can effect impartiality.

The fact that the court in *Falcone* decided such bias constituted a violation of the "fair hearing" right represents no departure in the law.[26] Nor is it startling that the disciplinary hearing should comport with rudimentary due process.[27] What is obvious in *Falcone* is that the court found a convenient flaw in the trial procedure—prejudgment—obviating the necessity of having to effect a change in the union's organic institutions.[28] Such circumvention seemingly forwards the policies of union self-development and governmental non-intervention as Congress intended, but because courts hold so narrowly on procedural points there is a dearth of procedural guidelines.[29] Also evident in *Falcone* and in most disciplinary cases having political overtones is the unwillingness of the courts to reach the subtler bias built into the procedure itself.[30]

An example of such illusory bias is the merging of prosecutorial and adjudicating functions which is common in many unions.[31] In *Parks v. International Brotherhood of Electrical Workers*[32] the international revoked a local's charter for having participated in a strike without its authorization. The union's constitution vested in the international's president combined prosecuting and judicial functions. In executing his duties the president ordered the charges to be brought, then conferred with the union's general counsel in the preparation of the revocation order, and ultimately ordered the local's charter revoked.[33] The court stated that while it might be desirable to adopt procedures that keep trial

[26] *See, e.g.*, Gulickson v. Forest, 290 F. Supp. 457 (E.D.N.Y. 1968); Local 7, Bricklayers, Masons and Plasterers v. Bowen, 278 F. 271 (S.D. Tex. 1922); Edrington v. Hall, 168 Ga. 484, 148 S.E. 403 (1929); Summers, *Part One: Internal Relations Between Unions & Their Members*, 18 RUTGERS U.L. REV. 236, 271 (1964).

[27] Parks v. International Bhd. of Elec. Workers, 314 F.2d 886 (4th Cir. 1963).

[28] Summers, *The Law of Union Discipline: What the Courts Do in Fact*, 70 YALE L.J. 175, 200 (1960). Professor Summers says that courts use such tactics in about two thirds of the discipline cases where they grant relief.

[29] *Id.*

[30] Aaron, *The Labor-Management Reporting & Disclosure Act of 1959*, 73 HARV. L. REV. 851, 873-74 (1960).

[31] The union constitution in Falcone specifically excluded charging parties from the union tribunal. 420 F.2d at 1161 n. 5.

[32] 314 F.2d 886 (4th Cir. 1963).

[33] *Id.* at 901.

functions separate, federal courts have not been authorized to restructure disciplinary procedures. It applied the same standard for eliminating bias that was used in *Falcone*:

> Courts, federal courts especially, are justified in ruling a union tribunal biased only upon a demonstration that it has been substantially actuated by improper motives—in other words, only upon a showing of specific prejudice.[34]

Unfairness related to merger of prosecutorial and adjudicative functions, however, could be easily corrected compared with the unfairness that arises from intra-political realities. *Falcone* is typical of cases involving political conflict between minority and "establishment" groups within the union,[35] and in these disputes, bias can be even more subtle than in cases dealing with the merger problem. Where relief has been given in such cases, courts have reversed the tribunals on substantive grounds[36] or at least given a close reading to the evidence.[37] In general they have not attacked the procedural mechanisms directly. In a recent case[38] a union member, convicted by the tribunal of making defamatory statements about union officials, claimed he was denied the right to a fair hearing under the LMRDA because his accusers were business agents having substantial power within the union. The court upheld the tribunal, pointing out that such officials were vested with the "responsibility for

[34] *Id.* at 913. The court in *Parks* alluded to the non-intervention policy which has proved powerful: "It may well be thought desirable for unions to adopt hearing procedures that keep trial functions separate, but the federal courts are not empowered so to restructure the disciplinary procedures of unions. *Id.* at 913. *Cf.* Summers, *Legal Limitations on Union Discipline*, 64 HARV. L. REV. 1049, 1083 (1951) (implied). In another case in which a union member had been charged with dereliction of his duties as shop steward, and later convicted, the district council was the charging body, serving also as the pool for members of the trial body. The court said that despite the fact that plaintiff claimed that members of the district council, who served as the trial committee, were "so personally embroiled in the bringing or prosecution of the charges as to render the trial unfair" there was no proof of actual bias and held for the union. Null v. Carpenters Dist. Council of Houston, 239 F. Supp. 809 (S.D. Tex. 1965).

[35] Political acts, in the broad sense, can include acts which in any way affect the legitimacy or influence of groups in power within the union at a particular time. Since Falcone threatened the will of the union leadership, his acts were "political" in nature.

[36] *See, e.g.*, Salzhandler v. Caputo, 316 F.2d 445 (2d Cir.), *cert. denied*, 375 U.S. 946 (1963).

[37] Vars v. International Bhd. of Boilermakers, 320 F.2d 576 (2d Cir. 1963).

[38] Cornelio v. Metropolitan Dist. Council, Bhd. of Carp. & Joiners, 243 F. Supp. 126 (E.D. Pa. 1965), *aff'd per curiam*, 358 F.2d 728 (3d Cir. 1966), *cert. denied*, 386 U.S. 975 (1967).

the proper administration of union affairs"[39] and thus could possess such power.

Institutional bias has been most pronounced, perhaps, in disputes concerning affiliation with subversive groups.[40] In *Anderson v. Brotherhood of Carpenters*[41] the accused had been acquitted of falsely answering questions concerning communist affiliation on his union membership application. Subsequently, however, the international found him guilty, suspending him from membership. At a second trial, ordered because of irregularities in the first,[42] the same chairman served as had served on the first convicting tribunal, and opposing witnesses were called "our witnesses" or the "committee's witnesses." Nevertheless, the court affirmed the second conviction saying, "A reasonable amount of tolerance must be accorded lay members of a Committee in conducting a hearing of this kind when they depart from the conventional standards usually recognized by a Committee of greater experience."[43]

It seems clear that the union tribunal is not and probably cannot be disinterested—the bias is an "inevitable product of the procedure itself."[44] The very *raison d'etre* of the typical union—economic action—decreases the likelihood of impartiality.[45] According to one source, twenty-six, out of seventy-two, unions designate their local executive boards as the trial bodies, and these unions represented over five and one-half million union members in 1959.[46] The same study showed that in eighteen unions, representing approximately four million members, the majority

[39] *Id.* at 129.

[40] Summers, *The Law of Union Discipline: What Courts Do in Fact*, 70 YALE L.J. 175, 199 (1960).

[41] 59 L.R.R.M. 2684 (D. Minn. 1965).

[42] The court found such glaring defects as the tribunal's refusal to allow the accused to confront or cross-examine either his accusers or adverse witnesses. *Id.* at 2685.

[43] *Id.* at 2688. In one recent case a union tribunal was found to have been biased in a disciplinary proceeding where four of the five members of the trial board (which consisted of the executive committee) had been political opponents of the accused. The bias found, however, was actual and not at all subtle. Gulickson v. Forest, 290 F. Supp. 457 (E.D.N.Y. 1968).

[44] Summers, *Legal Limitations on Union Discipline*, 64 HARV. L. REV. 1049, 1083 (1951).

[45] Dealing with a "defamation" case, one court explained:

> But the union is not a political unit to whose disinterested tribunals an alleged defamer can look for an impartial review of his "crime." It is an economic action group, the success of which depends in large measure on a unity of purpose and sense of solidarity among its members.

Salzhandler v. Caputo, 316 F.2d 445, 450 (2d Cir. 1963).

[46] L. BROMWICH, UNION CONSTITUTIONS 33 (1959).

elected tribunals, while in nine, representing approximately three million, trial board arrangements were left to the discretion of the locals.[47] Control in most unions remains with the dominant political faction, dealing a blow to the possibility of an unbiased tribunal or internal democracy.[48]

Institutional factors have weighed heavily on intra-union trials and on the degree of success which the judiciary has had in ferreting out bias. However, the record in some branches of administrative law suggests that courts have not been as reluctant to act as they have been in the intra-union setting. A brief survey of cases in administrative law demonstrates the greater impact which judicial review has had in that field.

The legislatures in most states delegate to an administrative tribunal the power to hear and resolve charges against physicians as well as to revoke licenses.[49] In an Illinois case,[50] a doctor charged with malpractice for having used a controversial treatment of cancer was tried before a trial committee comprised of physicians belonging to the American Medical Association, a group long criticizing the accused and the treatment he prescribed. The accused argued that since all five members of the committee belonged to the AMA, he could not receive a fair trial. Although there was no evidence of any specific bias by any member of the tribunal, the court held for the physician. In another licensing case, *State Board of Chiropractic Examiners v. Hobson*,[51] the doctor who served as board chairman in hearings resulting in the revocation of the defendant's license was disqualified because he was married to the licensee's former wife. The court reasoned, by analogizing to the relationship a juror would have to a litigant, that members of administrative tribunals have just as high a duty to insure against bias as jurors.[52]

In a case involving the disciplining of a cadet for having led an unauthorized "mass movement" at a merchant marine academy, the student asserted that members of the panel awarding the demerits had participated in the initial investigation.[53] He argued that because the

[47] *Id.* The study showed that eight unions allowed the president of the local to select the trial board, six provided that the local meeting was the trial board, and three had no formal provisions.

[48] *Id.* at 35.

[49] 41 AM. JUR. *Physicians & Surgeons* § 58 (1942).

[50] Smith v. Department of Reg. & Educ., 412 Ill. 332, 106 N.E.2d 722 (1952).

[51] 71 Dauphin County 234 (1958), *cited in* Annot., 97 A.L.R.2d 1210, 1218 (1964).

[52] *Id.*

[53] Wasson v. Trowbridge, 382 F.2d 807 (2d Cir. 1967).

authorities merged the functions of policeman and judge, he was deprived of an unbiased tribunal and fair hearing. The court agreed and added, "It is too clear to require argument or citation that a fair hearing presupposes an impartial trier of fact and that *prior official involvement in a case renders impartiality most difficult to maintain.*"[54]

Similarly, courts have moved with dispatch to eradicate bias in labor-management disputes. In one NLRB case the respondents opposed a petition to enforce certain orders because the trial was conducted by a "biased and partisan examiner who started out with a fell and partisan purpose to convict."[55] The court, in vacating the order, enunciated a rigorous standard for impartiality:

> [A] fair trial by an unbiased and non-partisan trier of the facts is of the essence of the adjudicatory process as well when the judging is done in an administrative proceeding by an administrative functionary as when it is done in a court by a judge. Indeed, if there is any difference, the rigidity of the requirement that the trier be impartial and unconcerned in the result applies more strictly to an administrative adjudication where many of the safeguards which have been thrown around court proceedings have, in the interest of expedition and a supposed administrative efficiency been relaxed.[56]

The judiciary has attempted to transport administrative standards into union disciplinary situations, but this has been notably unsuccessful, partly because the average union member is not experienced, as are many administrative officers, in trial procedure.[57] Furthermore, Congress'

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[54] *Id.* at 813 (emphasis added).

[55] NLRB v. Phelps, 136 F.2d 562 (5th Cir. 1943).

[56] *Id.* at 563. *See* Long Beach Federal Sav. & Loan Ass'n v. Federal Home Loan Bank Bd., 189 F. Supp. 589 (S.D. Cal. 1960) for a more recent case which follows the quoted standard. In that decision the court relied on constitutional precepts:

> It may be said . . . that the right to an impartial judge or quasi-judicial officer, free from bias, prejudice, interest or other ground of disqualification, is a fundamental right, protected by the due process clause of the Fifth Amendment . . . .

Id. at 610.

[57] According to Professor Summers, courts, in trying to eliminate bias, have instead compounded the problems by importing administrative law standards into the labor law. He has noted the difficulties encountered because courts have relied on administrative law precepts:

> [T]he union tribunal is always composed of members who are . . . interested, if not prejudiced, parties. They have no independence, no expertise, and no restraining tradition. To this type of tribunal the courts have attempted to apply standards designed to govern administrative agencies composed of experienced and impartial triers of fact . . . . The presumption of regularity

mandate that unions be free of excessive government intervention as well as the peculiarities of unions as economic units in a highly competitive society have made it unlikely that the judiciary will solve the problem of union bias. It is evident that the standard subscribed to by the *Falcone* court—demanding a demonstration of actual bias—is wholly ineffectual. The higher standard implicit in Judge Freedman's concurring opinion would involve more intensive judicial surveillance and participation in union affairs because the court would virtually serve as a reforming agent. Since Congress has negated any kind of judicial intervention that would reshape institutions, and has instead encouraged a *laissez-faire* approach, it is doubtful that Judge Freedman's more exacting standard could be achieved.

Perhaps the most encouraging alternative for realizing the truly unbiased tribunal lies outside of the court system in the concept of independent, public review. Initially used by the Upholsterer's International Union, this procedure was adopted by the constitutional convention of the United Auto Workers' Union in 1957.[58] The UAW Public Review Board is made of seven "impartial persons of good public repute,"[59] appointed by the UAW president, subject to the approval of both the executive board and the convention.[60] In disciplinary cases the member must first exhaust the internal remedies of the union, including appeal to the international executive board. If he is dissatisfied, he may then appeal either to the Public Review Board or to the UAW convention, but not to both.

What is significant is not the specific procedure followed by the UAW but the wide ramifications this system holds for unions, individual members and for society. The review board is neither an instrument of the union administration nor of the government—it is public. Moreover, it is voluntary. Independent review separates the executive power and the

applicable to administrative bodies cannot safely be applied to a union trial committee . . . .

Summers, *Legal Limitations on Union Discipline*, 64 HARV. L. REV. 1049, 1083 (1951).

[58] See Oberer, *Voluntary Impartial Review of Labor: Some Reflections*, 58 MICH. L. REV. 55, 56 (1959).

[59] UAW CONST., art. 31, §§ 1, 2.

[60] J. STIEBER, W. OBERER, M. HARRINGTON, DEMOCRACY & PUBLIC REVIEW 10-11 (1960). Senator McClellan, chairman of the Select Committee to Investigate Improper Activities in Labor-Management Relations, proposed independent final review during debate on the labor legislation in 1959, but his proposal was rejected. *See, e.g.*, Rothman, *Legislative History of the "Bill of Rights" for Union Members*, 45 MINN. L. REV. 199, 216 (1960).

ultimate judicial power within the union, making the dominant faction in the union subject to some superior law. It also eliminates the need for judicial review insofar as detecting bias is concerned since such review bodies act not only as arbiters of unresolved disputes but also as watchdogs over the union's internal disciplinary mechanisms. The attributes of public review would appear to best circumvent the institutional peculiarities of the union.

Dr. Clark Kerr, one of the original members of the UAW's Public Review Board, summarized the broader problem succinctly:

> The union, like every other major institution in an increasingly industrialized nation, has become more distant from its members. In the process of centralization the union administration has tended to take on a life and power of its own. The individual member remains the theoretical source of authority within the organization, but in a struggle with his own officers he is, more often than not, unable to muster the resources to make his sovereignty meaningful. The odds are with the administration.[61]

While independent judiciaries would not totally eliminate bias from union proceedings, they would help reverse the odds. Independent review would remind union leadership of the importance of due process principles as applied to internal institutions, and in this respect would strengthen existing disciplinary apparatus. It would also make evident to all members the close relationship that exists between the ends of justice and the means by which they are attained.[62] The correlation between union democracy and union strength is obvious, and only when more union leaders demonstrate the courage and wisdom to abdicate some of their own power to independent review bodies will union members receive the "full and fair hearing" guaranteed by the LMRDA.

GARBER A. DAVIDSON, JR.

Landlord and Tenant—Recent Erosions of Caveat Emptor in the Leasing of Residential Housing

The maxim caveat emptor has threaded a path through many areas of the law. While major modifications have occurred in some areas,[1] this

[61] DEMOCRACY & PUBLIC REVIEW, *supra* note 60, at 3.
[62] *Id.* at 30-31.

[1] UNIFORM COMMERCIAL CODE §§ 2-314, -315; *see* 8 S. WILLISTON, CONTRACTS

dubious doctrine, with few exceptions, has tenaciously persisted in the area of landlord and tenant law. However, recent decisions[2] in several jurisdictions have virtually excised caveat emptor from residential leases by implying either a warranty or covenant of habitability on the basis of local housing codes. As defined by one court:

> [I]t is a covenant that at the inception of the lease, there are no latent defects in facilities vital to the use of the premises for residential purposes because of faulty original construction or deterioration from age or normal usage. And further it is a covenant that these facilities will remain in usable condition during the entire term of the lease. In performance of this covenant the landlord is required to maintain those facilties in a condition which renders the property livable.[3]

While fundamental, it bears repetition that at common law a lease was considered a conveyance of an estate in land.[4] The concept of land as the central element of the leasehold has yielded several important and disadvantageous consequences for the lessee. Lease covenants, contrary to the contracts rule, are assumed to be independent.[5] The obligation to pay rent might continue despite the lessor's breach of a covenant to repair,[6] or even despite the destruction of the premises.[7] As the lessor has parted with possession, he is under no obligation to repair in the absence of express covenant or statute.[8] Where there are defects existing at the

§§ 983-89 (Jaeger ed. 1964); Prosser, *The Implied Warranty of Merchantable Quality*, 27 MINN. L. REV. 117 (1943).

[2] Javins v. First Nat'l Realty Corp., 428 F.2d 1071 (D.C. Cir. 1970); Brown v. Southall Realty Co., 237 A.2d 834 (D.C. App. 1968); Lemle v. Breeden, 462 P.2d 470 (Hawaii, 1969); Lund v. McArthur, 462 P.2d 482 (Hawaii, 1969); Marini v. Ireland, 56 N.J. 130, 265 A.2d 526 (1970); Reste Realty Corp. v. Cooper, 53 N.J. 444, 251 A.2d 268 (1969).

[3] Marini v. Ireland, 56 N.J. 130, —, 265 A.2d 526, 534 (1970).

[4] 1 AMERICAN LAW OF PROPERTY § 3.2 (A.J. Casner ed. 1952) [hereinafter cited as Casner].

[5] 6 S. WILLISTON, CONTRACTS § 890 (Jaeger ed. 1962).

[6] *E.g.*, Stone v. Sullivan, 300 Mass. 450, 15 N.E.2d 476 (1938).

[7] Fowler v. Bott, 6 Mass. 63 (1809); Coogan v. Parker, 2 S.C. 255 (1871).

[8] Casner § 3.78. The statutory duty to repair typically takes three forms. The "repair and deduct" category applies broadly to any "building intended for the occupation of human beings" and requires the lessor, in the absence of contrary agreement, to put and maintain the premises in tenable condition. The tenant has the alternative remedies of vacating or repairing the defect and deducting the amount from the rent; the expenditures may not exceed one month's rent in some of these statutes. *See, e.g.*, CAL. CIV. CODE §§ 1941-42 (West 1954); MONT. REV. CODES ANN. §§ 42-201, -202; N.D. CENT. CODE § 47-16-12 (1960); OKLA. STAT. ANN. tit. 41, §§ 31-32 (1954); S.D. COMPILED LAWS ANN. §§ 43-38-8, -9 (1967). Another form applies only to "multiple dwellings" or "tenement houses" and imposes specific duties. *E.g.*, CONN. GEN. STAT. REV. § 19-343 (1958); MASS.

commencement of the term, the lessee takes "as is" and his "eyes are his bargain."[9] Succinctly stated:

> There is no implied covenant or warranty that at the time the term commences the premises are in a tenable condition or that they are adapted to the purpose for which leased. The tenant, then, cannot use such unfitness . . . as a defense to rent. . . . The reason . . . is that the tenant is the purchaser of an estate in land, subject to the doctrine of *caveat emptor*. He may inspect the premises and determine for himself their suitability or he may secure an express warranty.[10]

The rule is not inexorable, however. One early exception was the letting of a "furnished house" for a short term. In such instances caveat emptor is thought inapplicable as the parties contemplate immediate occupation without prior inspection and "may be supposed to contract in reference to a well understood purpose of the hirer to use it as a habitation."[11] Despite infrequent extensions,[12] this exception has been narrowly construed and held applicable only to furnishings and defects existing at the beginning of the term.[13] Of more recent vintage is the rule implying a covenant of fitness for the purpose leased where the lease restricts the tenant to a particular use and is accepted by him before the premises are completely constructed or altered.[14] As in the "furnished house" situation, the lack of opportunity for inspection is the stated rationale for implying the covenant.

Further mitigation of the tenant's plight is afforded through the doctrines of constructive eviction and the implied covenant of quiet enjoyment.[15] By these theories, any act or omission of the landlord that

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ANN. LAWS ch. 144, §§ 66-89 (1965); N.Y. MULT. DWELL. LAW §§ 78-80 (McKinney 1946). Others impose broad liability on all lessors and specifically allow an action in tort for damages. GA. CODE ANN. §§ 61-111, -112 (1966); LA. CIV. CODE ANN. arts. 2692-95 (1952). See generally, Feuerstein & Shestack, *Landlord and Tenant—The Statutory Duty to Repair*, 45 ILL. L. REV. 205 (1950).

[9] Moore v. Weber, 71 Pa. 429, 432 (1872).

[10] Casner § 3.45.

[11] Ingalls v. Hobbs, 156 Mass. 348, 350, 31 N.E. 286 (1892); *accord*, Young v. Povich, 121 Me. 141, 116 A. 26 (1922); Hackner v. Nitschke, 310 Mass. 754, 39 N.E.2d 644 (1942); *cf.* Franklin v. Brown, 118 N.Y. 110, 23 N.E. 126 (1889). See Comment, *Implied Warranty of Habitability in Lease of Furnished Premises for Short Term:Erosion of Caveat Emptor*, 3 U. RICH. L. REV. 322 (1969).

[12] *See, e.g.*, Delamater v. Foreman, 184 Minn. 428, 239 N.W. 148 (1931) (multiple apartment buildings, furnished or unfurnished).

[13] Davenport v. Squibb, 320 Mass. 629, 70 N.E.2d 793 (1947); Murray v. Albertson, 50 N.J.L. 167, 13 A. 394 (1888).

[14] Woolford v. Electric Appliances, 24 Cal. App. 2d 385, 75 P.2d 112 (1938); J.D. Young Corp. v. McClintic, 26 S.W.2d 460 (Tex. Civ. App. 1930).

[15] Casner § 3.47; 2 R. POWELL, REAL PROPERTY ¶ 225(3) (Rohan ed. 1967).

renders the premises substantially unsuitable for their intended purpose or that seriously interferes with the tenant's beneficial enjoyment is a breach of the covenant and may constitute a constructive eviction. Both doctrines evolved from a recognition that the common law estate theory did not conform to modern urban life.[16] However, these doctrines have not fully overcome the harshness of caveat emptor. The act or omission must be substantial and of permanent effect.[17] Moreover, the lessor must be under some legal duty to act on the tenant's behalf. Lacking such duty, there can be no constructive eviction.[18] Further, the tenant must abandon the premises within a reasonable time on pain of waiver. "A tenant cannot claim uninhabitability, and at the same time continue to inhabit."[19]

The logic is admirable, but the tenant's position is dilemmic. If the breach is afterwards determined insubstantial, he is still liable on the rental agreement; if he dallies too long, he is deemed to have waived the defects.[20] The abandonment requirement can itself be harsh; in periods of adequate housing shortage the indigent tenant, in particular, may find suitable housing difficult to obtain, if he can find any at all.[21] Some limited relief from the abandonment rule has been afforded through the doctrines of partial *actual* and partial *constructive* eviction,[22] and also where the

[16] *See* Rapacz, *Origin and Evolution of Constructive Eviction in the United States*, 1 DEPAUL L. REV. 69, 70 (1951).

[17] *Id.* at 79-87.

[18] *E.g.*, Hopkins v. Murphey, 233 Mass. 476, 124 N.E. 252 (1919).

[19] Two Rector Street Corp. v. Bein, 226 App. Div. 73, 76, 234 N.Y.S. 409, 412 (1929). *See also* Candell v. Western Fed. Sav. & Loan Ass'n, 156 Colo. 552, 400 P.2d 909 (1965); Richards v. Dodge, 150 So.2d 477 (Fla. 1963); Venters v. Reynolds, 354 S.W.2d 521 (Ky. 1962); 52 C.J.S. *Landlord and Tenant* § 457 (1968).

[20] 52 C.J.S. *Landlord and Tenant* §§ 455, 459 (1968). *See* Annot., 91 A.L.R.2d 638 (1963).

[21] Poor tenants complain of housing code violations . . . but they cannot move away. They are immobilized by lack of funds or by their race. Code administrators hesitate to act because . . . it may mean more evicted tenants with no place to go.

P. WALD, LAW AND POVERTY: 1965 REPORT TO THE NATIONAL CONFERENCE ON LAW AND POVERTY 14 (1965), *cited in* Gribetz and Grad, *Housing Code Enforcement: Sanctions and Remedies*, 66 COLUM. L. REV. 1254, 1275 n.95 (1966). *See also* Schoshinski, *Remedies of the Indigent Tenant: Proposal for Change*, 54 GEO. L.J. 519 (1966).

[22] It is well recognized that a partial actual eviction suspends the lessee's entire rent obligation although he retains possession of the remainder of the premises. The lessor may not apportion his wrong. *See, e.g.*, Fifth Ave. Bldg. Co. v. Kernochan, 221 N.Y. 370, 117 N.E. 579 (1917). Fewer courts have embraced the theory of partial constructive eviction. In one case the lessee, with a "fortitude born of desperation," remained in his fire gutted apartment while the lessor, as obligated, failed to promptly repair. Noting the acute housing shortage, the court held it "intolerable that the tenant . . . must cling to the naked possession of the un-

tenant seeks equitable relief for breach of covenant.[23]

In recent years several courts have endeavored to depart from caveat emptor; three distinct approaches have added momentum to the judicial efforts to circumvent that doctrine. *Pines v. Perssion*[24] provided a major impetus for this recent development. In *Pines* several students, prior to leasing a furnished dwelling, inspected the premises and found them admittedly "filthy." In reliance upon the lessor's oral promise to repair, the lease was signed but no repairs were effected. After the students took possession certain defects, latent at the time of leasing, caused the house to be found in violation of the local building code. The tenants vacated and sued to recover their rent deposit and other expenditures. Despite caveat emptor, the court held they were not chargeable with knowledge of these latent defects and held that an implied warranty of habitability existed. While the court's decision was based on the early "furnished house" exception, the reasoning was much broader:

> Legislation and administrative rules, such as the safe place statute, building codes, and health regulations, all impose certain duties on a property owner with respect to the condition of his premises. Thus, the legislature has made a policy judgment—that it is socially . . . desirable to impose these duties on a property owner—which has rendered the old common law rule obsolete. To follow the old rule of no implied warranty of habitability in leases would . . . be inconsistent with current legislative policy concerning housing standards. The need and social desirability of adequate housing for people in this era of rapid population increases is too important to be rebuffed by that obnoxious legal cliché, *caveat emptor*.[25]

The breach of the warranty constituted a failure of consideration, and the tenants, in recovering, were held liable only "for the reasonable rental value of the premises during the period of actual occupancy."[26]

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inhabitable . . . without redress from the inexorable accrual of full rent." Johnson v. Pemberton, 197 Misc. 739, —, 97 N.Y.S.2d 153, 155-56 (City of N.Y. Mun. Ct. 1950); See also Majen Realty Corp. v. Glotzer, 61 N.Y.S.2d 195 (City of N.Y. Mun. Ct. 1946). The theory, however, does not completely extinguish liablity for rent. Gombo v. Martise, 41 Misc. 2d 475, 246 N.Y.S.2d 750, *rev'd*, 44 Misc. 2d 239, 253 N.Y.S.2d 459 (Sup. Ct. 1964). Most authority requires an eviction for breach of the implied covenant of quiet enjoyment, at least where claimed in defense to an action for rent. Moe v. Sprankle, 32 Tenn. App. 33, 221 S.W.2d 712 (1949); 49 Am. Jur. *Landlord and Tenant* § 333 (1970).

[23] Charles E. Burt, Inc. v. Seven Grand Corp., 340 Mass. 124, 163 N.E.2d 4 (1959).

[24] 14 Wis. 2d 590, 111 N.W.2d 409 (1961).

[25] *Id.* at 595-96, 111 N.W.2d at 412-13.

[26] *Id.* at 597, 111 N.W.2d at 413. The rationale in *Pines* was followed in Buckner

The court's rationale in *Pines* was later utilized by the New Jersey Supreme Court in *Reste Realty Corp. v. Cooper.*[27] In *Reste* the defendant lessee had rented office space in a commercial building; during the first year of occupancy, rainfall from an adjacent driveway caused periodic flooding rendering the offices unsuitable for the lessee's purposes. With knowledge of this defect, the lessee negotiated a second lease in reliance on the lessor's oral promise to correct the flooding. No corrections were made and the tenant abandoned after notice. Neither lease obligated the lessor to repair, nor contained any warranty of fitness. In a suit for accrued rent the lessor, as usual, asserted caveat emptor, and noted, particularly, the lease provisions reciting examination of the premises and agreement to accept them in "present condition." The argument proved unavailing:

> It has come to be recognized that ordinarily the lessee does not have as much knowledge of the condition of the premises as the lessor. Building code requirements and violations are known or made known to the lessor, not the lessee. He is in a better position to know of latent defects, structural or otherwise . . . which might go unnoticed by a lessee who rarely has sufficient knowledge or expertise to discover them. . . .
>
> . . . .
>
> [I]n our judgment present day demands of fair treatment for tenants with respect to latent defects remediable by the landlord . . . require imposition on him of . . . a limited warranty of habitability.[28]

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v. Azulai, 251 Cal. App. 2d 1013, 59 Cal. Rptr. 806 (1967), in which the court found an implied warranty of habitability and allowed the tenant to recover a prior rent deposit. The court also held invalid a purported waiver of the lessor's duty to repair under CAL. CIV. CODE § 1941. However, the *Pines* rationale was recently emasculated in Posnanski v. Hood, 46 Wis. 2d 172, 174 N.W.2d 528 (1970). The court refused the tenant's request to hold that the lessor's compliance with a local housing code was an implied covenant in the lease, reasoning

> [to hold] that the housing code is implied in lease agreements . . . would circumvent the existing enforcement procedures . . . a tenant would withhold rent and the case would then be taken into court by the landlord for ejectment, nonpayment of rent, or both . . . judicial definition of terms in the housing code would supplant administrative regulation.

Id. at —, 174 N.W.2d at 533. One reply is that administrative enforcement is frequently unsuccessful. Inspectors typically face masses of minor violations, problems of overlapping agency jurisdiction, inspection, and sometimes difficult decisions in determining the party to be held responsible. While criminal sanctions—the primary enforcement mechanism—are potentially adequate (see N.Y. MULT. DWELL. LAW § 304 (McKinney Supp. 1970)), they have frequently proven ill-suited in effecting the goals of maintenance and repair. *See* Gribetz and Grad, *Housing Code Enforcement: Sanctions and Remedies,* 66 COLUM. L. REV. 1254 (1966); Comment, *Enforcement of Municipal Housing Codes,* 78 HARV. L. REV. 801 (1965).

[27] 53 N.J. 444, 251 A.2d 268 (1969).

[28] *Id.* at 452-54, 251 A.2d at 272-73.

While the defects were obvious at the inception of the second and controlling lease, this fact did not preclude reliance upon the newly implied warranty due to the lessor's oral promise to repair, though "knowing acceptance of a defective leasehold would normally preclude reliance upon any implied warranties . . . ."[29] Strangely, the court based its decision on a more traditional ground holding that the tenant was constructively evicted by breach of an express covenant of quiet enjoyment. It has been urged that the result was unique since the covenant of quiet enjoyment traditionally embraces only interference with the tenant's beneficial use from conditions attributable to the lessor and manifested after occupancy, but does not warrant initial fitness where, as here, there is no change of condition.[30]

The dicta in *Reste* concerning the covenant of habitabiltiy was later the *ratio decidendi* in *Marini v. Ireland*.[31] The defendant lessee held a one year apartment lease that contained an express covenant of quiet enjoyment but no covenant to repair. During occupancy, defects in the plumbing caused flooding; repeated attempts to inform the lessor failed. The lessee then employed self-help, had the plumbing repaired, and deducted the amount from the monthly rent. Drawing on *Pines* and *Reste*, the New Jersey court reversed the lower court decision for the lessor in his ejectment suit and held the self-help remedy available. Significantly, the court did not rely on the covenant of quiet enjoyment[32] but, noting that the lease prohibited use "for any other purpose than dwelling," concluded that an implied covenant of habitability arose "because it is indispensable to carry into effect the purpose of the lease . . . ."[33]

This approach of construing the terms of the lease raises the question of whether a purported waiver of any implied covenants in the lease should be given recognition. One authority cited in *Marini* considered it "well settled that courts will not make a better . . . contract than the parties themselves have seen fit to enter into."[34] The question is not academic; as such covenants are increasingly implied, form leases will undoubtedly contain specific waivers of the covenants. The validity of such a waiver

[29] *Id.* at 455, 251 A.2d at 274.

[30] *See* Note, *Landlord and Tenant: A Further Erosion of "Caveat Emptor": Reste Realty Corporation v. Cooper*, 31 U. PITT. L. REV. 138 (1969).

[31] 56 N.J. 130, 265 A.2d 526 (1970).

[32] See Note, 31 U. PITT. L. REV. 138, *supra* note 30.

[33] 56 N.J. at —, 265 A.2d at 533.

[34] William Berland Realty Co. v. Hahne & Co., 26 N.J. Super. 477, 486, 98 A.2d 124, 129 (1953).

appears doubtful. Housing codes, even if not specific in placing the duty of compliance on the lessor, are enacted, in part, for the tenant's benefit in recognition of his frequent inequality of bargaining power.[35] It is similarly recognized that one cannot assume risk where a statute exists which thus serves to protect a party from himself.[36] *Reste* acknowledged this absence of arms length dealing in landlord-tenant relations and, though reserving decision on the issue, cited authority casting grave doubt that any waiver would be upheld.[37]

While the court in *Marini* considered the characterization of the new covenant a "mere matter of semantics," the conclusion that a breach "would constitute a constructive eviction"[38] seems unfortunate. Unless the court intended to embrace the as yet limited theory of partial constructive eviction,[39] the lessee's retention of possession was inconsistent with the abandonment requirement. The court, not unmindful of the problem, observed:

> It is of little comfort to a tenant in these days of housing shortage to accord him, upon a constructive eviction, the right to vacate the premises and end his obligation to pay rent. Rather he should be accorded the alternative remedy of terminating the cause of the constructive eviction.[40]

One must agree, and as the court's previous efforts in *Reste* suggest, such analytical inconsistencies seem inherent in attempts to accommodate new results within arguably outmoded property concepts.[41]

More unfortunate, however, were the limited remedies the court allowed for breach of the new covenant. In *Reste*, the court took note of the "drastic course" involved in abandonment and indicated approval of a rule allowing the tenant to withhold a portion of the agreed rent and to pay only the reduced "reasonable rental value" of the defective premises

[35] McNally v. Ward, 192 Cal. App. 2d 871, 14 Cal. Rptr. 260 (1961); Altz v. Leiberson, 233 N.Y. 16, 134 N.E. 703 (1922).

[36] Finnigan v. Royal Realty Co., 35 Cal. 2d 409, 218 P.2d 17; W. PROSSER, LAW OF TORTS § 67 (3d ed. 1964).

[37] Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960) (disclaimer of implied warranties held no bar to tort recovery for defective auto; Michaels v. Brookchester, Inc., 26 N.J. 379, 140 A.2d 199 (1958) (Tenement House Act held to create tort liability); UNIFORM COMMERCIAL CODE § 2-302 (unconscionable contract or clause).

[38] 56 N.J. at —, 265 A.2d at 534.

[39] See note 22 *supra*.

[40] 56 N.J. at —, 265 A.2d at 535.

[41] *See* Lesar, *Landlord and Tenant Reform*, 35 N.Y.U.L. REV. 1279 (1960).

if he elected not to abandon.[42] Yet the court in *Marini* made it explicit that "the tenant has *only* the alternative remedies of making the repairs or removing from the premises."[43] Moreover, he may effect only such repairs as "are reasonable in light of the value of the leasehold."[44] Such a rule is of least benefit to the indigent tenant who, as noted, may have no place to go if he abandons, but whose meager leasehold is most likely in need of extensive repair. He is probably unable to afford additional expenditures beyond the "reasonable" level if out of pocket.[45]

Finally, it is clear that the covenant as announced by the New Jersey court extends only to latent defects; the tenant who knowingly leases premises in a defective state will have no remedy for breach of the covenant. This qualification seems inconsistent with the court's acknowledgment in *Reste* that "an awareness by legislatures of the inequality of bargaining power between landlord and tenant in many cases, and the need for tenant protection, has produced remedial tenement house and multiple dwelling statutes."[46] To the extent that residental leases are formed in an adhesive context[47] and the various housing codes evidence a legislative determination that property owners must satisfy minimum duties of maintenance, it seems incongruent that the indigent tenant in a "take-it-or-leave-it" situation should be left exclusively to often inadequate administrative remedies.[48]

In contrast to the constructive eviction approach utilized in *Marini*, a more unique theory was employed by the District of Columbia Court of Appeals in *Brown v. Southall Realty Co.*[49] The landlord leased premises which, at the time of letting, were known by him to be defective and in violation of the housing code. When the tenant withheld rent, the lessor sued for possession. The tenant abandoned and disclaimed any future liability for rent on the grounds of illegality. The court agreed and found that the letting violated a regulation that "[N]o persons shall rent or offer to rent any habitation . . . unless . . . in repair." The letting was contrary

[42] 53 N.J. at 462 n.1, 251 A.2d at 277 n.1.

[43] 56 N.J. at —, 265 A.2d at 535 (emphasis added). *Cf.* Academy Spires, Inc. v. Brown, 111 N.J. Super. 477, 268 A.2d 556 (Dist. Ct. 1970).

[44] *Id.*

[45] See note 21 *supra.* See also Comment, *The Indigent Tenant and the Doctrine of Constructive Eviction,* WASH. U.L.Q. 461, 478 (1968).

[46] 53 N.J. at 452, 251 A.2d at 272.

[47] 2 R. POWELL, REAL PROPERTY ¶ 221(1) (Rohan ed. 1967).

[48] See note 26 *supra.*

[49] 237 A.2d 834 (D.C. App. 1968).

to public policy, and the lease void and unforceable.[50] The illegal contract theory in *Brown* involved only pre-existing and known defects; its application to situations in which the defects and violations arise after the letting is uncertain.[51] It might be argued that the landlord's continued provision of defective housing, despite initial compliance with the regulations, constitutes an illegal performance, renders an initially valid contract unenforceable and provides a good defense to an action for accrued rent if the violations were "serious or more than an incidental part of the performance."[52] However, substantial authority would reject this reasoning: "There is no policy . . . against . . . recovery unless [the] contract was illegal, and a contract is not necessarily illegal because it is carried out in an illegal way."[53]

The distinction appears unsound; what flouts public policy is the prohibited performance, not the contract as such. Housing codes typically require the lessor to maintain the premises in a healthy and safe condition. The failure to do so is no less illegal than the act of originally leasing the premises in a defective condition. It would be anomalous not to prohibit the lessor's recovery in both cases.[54]

The illegal contract theory produces the remedy of total rent withholding. Since the lease is void, the lessor may not assert it in an action for rent or ejectment. However, like the solution in *Marini*, the illegal contract theory may prove cold comfort to the indigent tenant. Entry under a void lease uniformly creates a tenancy at will, terminable on either reasonable or statutory notice.[55] The same result should obtain in the case of supervening illegality. Thus, the theory may become a double edged sword; a tenant might withhold his rent and successfully defend an action for rent or possession, but subject himself to later ouster.[56]

A third approach in departing from the caveat emptor doctrine was

[50] *Id.* at 836-37; see also Jess Fisher & Co. v. Hicks, 86 A.2d 177 (D.C. App. 1952); Leuthold v. Stickney, 116 Minn. 299, 133 N.W. 856 (1911).

[51] *See* Saunders v. First Nat'l Realty Corp., 245 A.2d 836 (D.C. App. 1968), *rev'd sub nom.* Javins v. First Nat'l Realty Corp., 428 F.2d 1071 (D.C. Cir. 1970).

[52] 6 S. WILLISTON, CONTRACTS § 1761 (Rev. ed. 1938).

[53] Fox v. Rodgers, 171 Mass. 546, 547, 50 N.E. 1041, 1042 (1898); *see* Measday v. Sweazea, 78 N.M. 781, 438 P.2d 525 (1968); *cf.* Tocci v. Lembo, 325 Mass. 707, 92 N.E.2d 254 (1950). *See generally* 17 C.J.S. *Contracts* § 190 (1963).

[54] See WILLISTON, *supra* note 52. *See also* RESTATEMENT OF CONTRACTS § 608 (1932).

[55] Casner §§ 3.27-28, 3.91. *See* Diamond Housing Corp. v. Robinson, 257 A.2d 492 (D.C. App. 1969).

[56] *See* Edwards v. Habib, 397 F.2d 687 (D.C. Cir. 1968).

taken by the Hawaii Supreme Court in *Lemle v. Breeden.*[57] The lessee's furnished "Tahitian style" dwelling proved rat infested and was abandoned within three days. While factually the case fell within the "furnished house" exception, and the tenant urged constructive eviction, the court eschewed both approaches. Unlike in *Marini*, the court asserted that "to search for gaps and exceptions in a legal doctrine such as constructive eviction which exists only because of the somnolence of the common law and the courts is to perpetuate further judicial fictions when preferable alternatives exist."[58] The preferable alternative was simply a rejection of the "wooden rules of property law" and treatment of the lease as a bilateral contract and sale of the premises for a term.[59] The court, by thus analogizing a lease doctrinally to a sale and with additional assist from tort authority, had little difficulty in concluding that lessor's superior bargaining power and opportunity to inspect and maintain his product imply a warranty that the premises are suitable for their intended use as a habitation. The usual contract remedies of damages, reformation, and rescission are available to the lessee upon material breach, and the remedial problems of constructive eviction are eliminated.[60]

The implied warranty approach was recently followed in the District of Columbia in *Javins v. First National Realty Corporation.*[61] The tenants urged that violations of the housing regulations occurring after the leasing were a defense to the lessor's ejectment action. Regarding the treatment of leases as contracts "wise and well considered," the court reviewed the erosion of caveat emptor in consumer protection cases but declined to imply a general warranty of habitability in all urban leases. Instead, drawing on *Brown*, the court held that the housing regulations were implied terms of the leases they covered and created a non-waivable duty to comply with their standards. The opinion is suitably vague, however, on one result of this interaction between lease and housing regulation. In the lower court, the tenants argued both that the illegal contract theory of *Brown*

[57] 462 P.2d 470 (Hawaii 1969); *See* Lund v. MacArthur, 462 P.2d 482 (Hawaii 1969).

[58] 462 P.2d at 475.

[59] See Lesar, *supra* note 41, at 1281.

[60] 462 P.2d at 473-75; *see* note 1 *supra*, and *see also* Greenman v. Yuba Power Prod., Inc., 59 Cal. 2d 67, 377 P.2d 897, 27 Cal. Rptr. 697 (1962); Carpenter v. Donohoe, 154 Colo. 78, 388 P.2d 399 (1964); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960); Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 207 A.2d 314 (1965); Jaeger, *Product Liability: The Constructive Warranty*, 39 NOTRE DAME LAWYER 501 (1964).

[61] 428 F.2d 1071 (D.C. Cir. 1970).

extended to violations arising after the letting and that the regulations imposed an implied contractual duty on the lessor to maintain the property. Neither argument was accepted.[62] In reversing, the circuit court of appeals skirted the issue of supervening illegality: "Under the *Brown* holding, serious failure to comply. . . [with a regulation requiring maintenance and repair] . . . before the least term begins renders the contract void. We think it untenable to find that this section has no effect on the contract after it has been signed."[63] What remains uncertain is whether the "effect" of the regulations, in the case of defects arising after the leasing, is relevant to the validity of the lease itself. Logically, it would seem so. As the court in *Javins* acknowledged, under *Brown* the existence of substantial defects at the time of leasing "renders the contract void." The issue of illegality should not hinge on the fortuity of when the defects arose.[64] Moreover, an acknowledgment of illegality in both contexts—where the defects exist preceding the contract as well as where they subsequently arise—need not be inconsistent with the implication of a contractual duty enforceable by the tenant. Enforcement of an illegal contract is typically allowed where the enforcement is sought by a party who falls within the protected class for whose benefit the contract is judged illegal.[65]

Thus, from the tenant's viewpoint, the warranty and illegal contract theories may merely provide an overlapping choice of remedies. More problematical, however, is whether the lessor could assert the illegality of the lease in either context in defense to an action for breach of his warranty, thereby creating a tenancy at will and jeopardizing the lessee's right to future possession.[66] The possibility apparently exists; if broader social goals than tenant protection are served by code enforcement, then the illegal leasing suggests an *in pari delicto* situation. The "protected class" exception to the rule of non-enforcement of illegal contracts might not apply, and the lessor could, paradoxically, benefit from his own illegal behavior.[67] Indeed, the court which decided *Brown* later intimated this possibility:

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[62] Saunders v. First Nat'l Realty Corp., 245 A.2d 836 (D.C. App. 1968).

[63] 428 F.2d at 1081.

[64] See text at notes 52-54 *supra.*

[65] *See, e.g.*, Kneeland v. Emerton, 280 Mass. 371, 183 N.E.155 (1932); Loewenstein v. Midwestern Inv. Co., 181 Neb. 547, 149 N.W.2d 512 (1967); RESTATEMENT OF CONTRACTS § 601 (1932).

[66] *See* authorities cited *supra* note 55.

[67] 17 C.J.S. *Contracts* § 272 (1963).

> The Housing Regulations do not compel an owner of housing property to rent his property . . . if the landlord is unwilling or unable to put the property in a habitable condition, he may and should promptly terminate the tenancy and withdraw the property from the rental market, because the Regulations forbid both the rental and the occupancy of such premises.[68]

Of course, the thrust of *Javins* is contrary, but the problem is posed to illustrate that the illegal contract and warranty theories, where they coexist, may prove conflicting.

Like *Lemle, Javins* accorded the usual contract remedies, including specific performance, but also sanctioned the tenant's use of rent withholding. This remedy, first suggested in *Reste,* was later limited in *Marini* by the "repair" requirement. *Brown,* in effect, allowed total rent withholding but at the expense of voiding the lease. Upon breach of the warranty, the lessee may withhold rent and need not effect repairs, abandon, or institute suit. In an ejectment action, the lessor's breach, if partial, results in liability only for the fair rental value of the premises in their defective state; the lessee may retain possession if he tenders that amount. If the breach is total, no rent is owed, and the ejectment action fails.[69] Moreover, the tenant need not run the risk usually inherent in constructive eviction. He may have the premises inspected and ascertain whether substantial code violations exist. Even if it is later judged that no breach substantial enough to merit rent reduction ocurred, and ejectment is ordered, the tenant has at least enjoyed possession during the interim period.

The cases examined typify three distinct approaches employed in recent judicial assaults on caveat emptor in landlord-tenant law. The potential consequences of each is yet unclear, though some conceptual and remedial problems are presently apparent. It is hoped, however, that further re-evaluation of the "obnoxious legal cliché" will flow from the precedents now before the courts.

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[68] Diamond Housing Corp. v. Robinson, 257 A.2d 492, 495 (D.C. App. 1969).

[69] 428 F.2d at 1082. *See also* Bonner v. Beecham, 2 CCH POV. L. REP. ¶ 11,098 (Denver, Colo. County Ct. 1970).

Military Law—Courts-Martial Jurisdiction of United States Civilians in Vietnam

As the United States' involvement in Vietnam increased in the 1960's, the government found it necessary to deploy an increasingly large number of United States civilians to support our combat troops there. In a recent case, *United States v. Averette*,[1] the United States Court of Military Appeals[2] was directly presented with the question of whether these civilians are amenable to trial by court-martial for crimes committed in Vietnam.

Averette, a civilian employee of an army contractor in Vietnam, was a mobile equipment supervisor in charge of a motor pool at Camp Davies.[3] This job, which required Averette to work almost exclusively with active army personnel, entailed providing maintenance for all vehicles and equipment in the army motor pool at Saigon, keeping logbooks, and dispatching military vehicles.[4] These vehicles were used at five different army installations in Vietnam for repair and utility work and thus were in direct support of the war effort.[5] Additionally, Averette was closely integrated into the army life at Camp Davies in that "[h]e had access to a variety of Army facilities and benefits including the post exchange, the commissary, banking privileges, and other welfare and recreational activities."[6]

A general court-martial convicted Averette of conspiracy to commit larceny and attempted larceny of 36,000 Government-owned batteries.[7] The conspiracy involved military personnel with whom Averette was associated.[8] Appealing to the Court of Military Appeals, Averette successfully challenged the validity of the Army's jurisdiction by contending that since Congress had not formally declared war, the Vietnamese conflict did not constitute "a time of war" as required by article 2(10)[9] of

[1] 19 U.S.C.M.A. 363, 41 C.M.R. 363 (1970) (2-1 decision).

[2] Consisting of three civilian judges who hear appeals from all of the services, the Court of Military Appeals is the highest appellate court in the military judicial system. 10 U.S.C. § 867 (Supp. V, 1970).

[3] Averette v. Dillon, Civil No. L-863 (D. Kan., filed Jul. 24, 1969).

[4] *Id.* This intimate connection between Averette's employment and the military was not mentioned in the opinion of the Court of Military Appeals.

[5] *Id.* (not mentioned by the Court of Military Appeals).

[6] 19 U.S.C.M.A. at 365, 41 C.M.R. at —.

[7] *Id.* at 363, 41 C.M.R. at —.

[8] Averette v. Dillon, Civil No. L-863 (D. Kan., filed Jul. 24, 1969) (not mentioned by the Court of Military Appeals).

[9] UCMJ art. 2(10), 10 U.S.C. § 802(10) (1964) provides: "In time of war,

the Uniform Code of Military Justice.[10]

Before considering the validity of this contention and the effect of the court's acceptance of it, it is imperative to first consider the historical development of court-martial jurisdiction over civilians in general, and of article 2(10) specifically. The basis of American court-martial jurisdiction over civilians can be directly traced to a provision of the British Articles of War of 1765 which provided that "[a]ll Suttlers and Retainers to a Camp, and all persons whatsoever serving with Our Armies in the Field, though no inlisted Soldiers, are to be subject to the Rules and Discipline of War."[11] In 1775 the Continental Congress enacted into the American Articles of War[12] a strikingly similar provision, which was thereafter included without substantial change in each revision of the Articles of War up to and including the Articles of War of 1874.[13]

The first significant change came with the enactment of article 2(d)[14] of the Articles of War of 1916, which for the first time expanded military jurisdiction to encompass civilians who accompanied the armed forces outside the territorial limits of the United States *in time of peace*.[15] It was contended that such jurisdiction was a constitutionally valid exercise of Congress' power "[t]o make Rules for the Government and Regulation of the land and naval Forces."[16] Congress' power to establish military

persons serving with or accompanying an armed force in the field [are subject to trial by court-martial]."

[10] 10 U.S.C. §§ 801-940 (1964).

[11] British Articles of War of 1765 section XIV, article XXIII. Reprinted in W. WINTHROP, MILITARY LAW AND PRECEDENTS app. VII, at 941 (2d ed. reprint 1920) [hereinafter cited as WINTHROP].

[12] The Articles of War were statutory provisions enacted by Congress in furtherance of military administration and discipline. Although the original Articles of War predate the Constitution, the later Articles were enacted under Congress' article I legislative power "[t]o make Rules for the Government and Regulation of the land and naval Forces" and its broader "war powers," which can be found scattered throughout article I, section 8 of the Constitution.

[13] The various articles mentioned are reprinted in WINTHROP apps. VII-XIII 941-91.

[14] Article of War 2(d), Act of Aug. 29, 1916, ch. 418, § 1, 39 Stat. 651 provided for jurisdiction over:

> All retainers to the camp and all persons accompanying or serving with the armies of the United States without the territorial jurisdiction of the United States, and in time of war all such retainers and persons accompanying or serving with the armies of the United States in the field, both within and without the territorial jurisdiction of the United States, though not otherwise subject to these articles.

[15] F. WIENER, CIVILIANS UNDER MILITARY JUSTICE 227-31 (1967) [hereinafter cited as WIENER].

[16] U.S. CONST. art. I, § 8.

courts independent of article III judicial power[17] and to make civilians amenable to these courts during *wartime* had not been seriously questioned. Apparently it was assumed that this power could be extended to make certain civilians amenable to courts-martial during *peacetime*. At any rate article 2(d) remained unchanged in the two subsequent revisions[18] of the Articles of War, and substantially the same provision was enacted into the Uniform Code of Military Justice in 1950.[19] The traditional wartime jurisdictional provision can be found in article 2(10) of the Uniform Code,[20] while the peacetime extension of 1916 is set forth in article 2(11).[21]

Shortly after the Uniform Code was enacted, the Supreme Court began to look with disfavor upon any expansion of court-martial jurisdiction. This attitude, stemming largely from the fact that certain constitutional safeguards inherent in article III courts are not constitutionally required of military courts,[22] culminated in a series of Supreme Court holdings unconditionally striking down court-martial jurisdiction over civilians in time of peace.[23] Consequently, for all practical purposes, juris-

[17] Dynes v. Hoover, 61 U.S. (20 How.) 65, 79 (1857).

[18] Act of June 24, 1948, ch. 625, Title II. § 202, 62 Stat. 628, and Act of June 4, 1920, ch. 227, subch. II, § 1, 41 Stat. 787.

[19] Act of May 5, 1950, ch. 169, 64 Stat. 107 (now 10 U.S.C. §§ 801-940 (1964)). *Compare* Article of War 2(d), Act of August 29, 1916, ch. 418, § 1, 39 Stat. 651 *with* UCMJ arts. 2(10)-(11), 10 U.S.C. § 802 (10)-(11).

[20] See note 9 *supra*.

[21] UCMJ art. 2(11), 10 U.S.C. § 802(11) (1964) provides:

> Subject to any treaty or agreement to which the United States is or may be a party or to any accepted rule of international law, persons serving with, employed by, or accompanying the armed forces outside the United States and outside the following: the Canal Zone, Puerto Rico, Guam, and the Virgin Islands [are subject to trial by court martial].

[22] *E.g.*, the fifth amendment expressly exempts "cases arising in the land or naval forces. . . ." This exception has been extended by implication to the sixth amendment right to a jury trial. *Ex parte* Quirin, 317 U.S. 1, 40 (1942); *Ex parte* Milligan, 71 U.S. (4 Wall.) 2, 123 (1866). Furthermore, the array of safeguards provided in article III are not constitutionally required of military courts.

[23] Originally the Supreme Court had allowed court-martial jurisdiction over civilians in peacetime. Reid v. Covert, 351 U.S. 487 (1956); Kinsella v. Krueger, 351 U.S. 470 (1956). However, a rehearing was granted in both of these habeas corpus cases and subsequently the Court held that courts-martial could not constitutionally try civilian *dependents* charged with *capital* crimes *in time of peace*. Reid v. Covert, 354 U.S. 1 (1957). Less than three years later this holding was expanded to include *non-capital* offenses. Kinsella v. United States *ex rel.* Singleton, 361 U.S. 234 (1960). It was further extended to cover *capital* crimes committed by civilian *employees* of the armed forces in time of peace. Grisham v. Hagan, 361 U.S. 278 (1960). Finally it was extended to cover *non-capital* crimes committed by civilian *employees*. McElroy v. United States *ex rel.* Guagliardo, 361 U.S. 281 (1960). These were all habeas corpus proceedings. For a concise

diction under article 2(11) is void. Thus, if jurisdiction is to be obtained over civilians, it must be based on article 2(10), the wartime jurisdictional provision. In spite of their disapproval of subjecting civilians to military justice, the courts have long recognized that *wartime conditions* warrant some restriction of civilian rights.[24] Traditionally, jurisdiction in such cases has been based constitutionally not upon article I, section 8, clause 14 as was peacetime jurisdiction, but rather upon Congress' broader "war powers"[25] and has repeatedly been upheld as constitutional.[26] Indeed, Justice Black, recognizing Congress' broad "war powers" and the court-martial jurisdiction which coincides with these powers, wrote in *Reid v. Covert*: "We believe that Article 2(10) sets forth the maximum historically recognized extent of military jurisdiction over civilians under the concept of 'in the field.' "[27] Circuit Judge (now Chief Justice) Burger also recognized such wartime jurisdiction and expressed the view that "[w]ithout doubt military jurisdiction over essential civilian employees at overseas bases would be sustained in wartime."[28]

Since none of the cases striking down court-martial jurisdiction over civilians in peacetime directly affected the traditional wartime jurisdiction, the Army in *Averette* based jurisdiction on article 2(10). Before a civilian is amenable to court-martial under article 2(10) the three conditions of the provision must be met: the civilian must be (1) "serving with or accompanying an armed force" (2) "in the field" (3) during a "time of war." Thus the court in *Averette*, by holding that "war" means a war formally declared by Congress, found that the third condition was not met and further restricted military jurisdiction over civilians.

Chief Judge Quinn, dissenting in *Averette*,[29] noted that a federal district court in Kansas had earlier expressly rejected this view in denying

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discussion of the rise and fall of military jurisdiction over civilians in time of peace see WIENER app. IV.

[24] Reid v. Covert, 354 U.S. 1, 33 (1957).

[25] The "war powers" stem from article I, section 8, of the Constitution which gives Congress the power "[t]o make all Laws which shall be necessary and proper . . . [to] provide for the common Defence . . . declare War . . . raise and support Armies . . . provide and maintain a Navy . . . [and] provide for calling forth the Militia to execute the Laws of the Union . . . and repel Invasions. . . ."

[26] Perlstein v. United States, 151 F.2d 167 (3d Cir. 1945), *cert. granted*, 327 U.S. 777 (1946), *dismissed as moot*, 328 U.S. 822 (1946); Hines v. Mikell, 259 F. 28 (4th Cir. 1919), *cert. denied*, 250 U.S. 645 (1919).

[27] 354 U.S. 1, 34 n.61 (1957).

[28] United States *ex rel.* Guagliardo v. McElroy, 259 F.2d 927, 937 (D.C. Cir. 1958) (dissenting opinion).

[29] 19 U.S.C.M.A. at 366, 41 C.M.R. at —.

Averette habeas corpus relief.[30] A survey of the case law dealing with the interpretation of the words "in time of war" as used in a military sense lends support to Chief Judge Quinn's view that a formal declaration of war is not a prerequisite for the exercise of article 2(10) jurisdiction.[31] Also, the Supreme Court in 1800 declared that hostilities between the French and American naval forces were "war" notwithstanding the absence of a formal declaration by Congress.[32] The test enunciated was whether Congress had authorized the hostilities, not whether Congress had declared war.[33] Furthermore, war in the context of every American military code has consistently been interpreted by the courts to include undeclared wars.[34] Thus the Indian wars of the nineteenth century constituted war[35] as did the Boxer Rebellion in 1900.[36] The Court of Military Appeals itself previously followed this reasoning by observing that both the Korean[37] and Vietnamese[38] conflicts fell within "a time of war." Thus, arguably, the court had ample precedent to hold that the Vietnamese conflict constituted "a time of war."

Indeed, Chief Judge Quinn noted that less than three years earlier the Court of Military Appeals in *Latney v. Ignatius*[39] rejected a contention "that court-martial jurisdiction under Article 2(10) depended upon a specific declaration of war by Congress."[40] *Latney* is particularly significant because it, like *Averette*, is concerned with article 2(10) jurisdiction over a civilian in Vietnam. Considering the fact that Latney was

[30] Averette v. Dillon, Civil No. L-863 (D. Kan., filed Jul. 24, 1969).

[31] *See, e.g.*, Wiener, *Courts Martial for Civilians Accompanying the Armed Forces in Vietnam*, 54 A.B.A.J. 24 (1968) and the cases cited therein.

[32] Bas v. Tingy, 4 U.S. (4 Dall.) 37 (1800).

[33] *Id.* at 43-44.

[34] Wiener, *Courts Martial for Civilians Accompanying the Armed Forces in Vietnam*, 54 A.B.A.J. 24 (1968).

[35] Montoya v. United States, 180 U.S. 261 (1901).

[36] Hamilton v. McClaughry, 136 F. 445 (C.C.D. Kan. 1905).

[37] *See, e.g.*, United States v. Shell, 7 U.S.C.M.A. 646, 23 C.M.R. 110 (1957); United States v. Sanders, 7 U.S.C.M.A. 21, 21 C.M.R. 147 (1956); United States v. Ayers, 4 U.S.C.M.A. 220, 15 C.M.R. 220 (1954); United States v. Bancroft, 3 U.S.C.M.A. 3, 11 C.M.R. 3 (1953).

[38] United States v. Anderson, 17 U.S.C.M.A. 588, 38 C.M.R. 386 (1968). However, it must be pointed out that in *Averette* the Court of Military Appeals specifically mentioned this case and those cited in note 37 *supra* and noted that none concerned subjecting a civilian to military trial, but rather dealt with other provisions of the Code and affected defendants who were soldiers and thus already amenable to trial by court-martial. *But see* United States v. Burney, 6 U.S.C.M.A. 776, 787, 21 C.M.R. 98, 109 (1965).

[39] 17 U.S.C.M.A. 677 (1967).

[40] 19 U.S.C.M.A. at 366, 41 C.M.R. at —.

only negligibly connected with the military, it seems anomalous that when presented with *Averette*, in which the accused was intricately connected with the military, the court would disregard its former decision and require, for the first time, a formal declaration of war by Congress.

However, within two years after *Latney* was decided, two significant developments occurred which undoubtedly influenced the Court of Military Appeals: *O'Callahan v. Parker*[41] was decided by the Supreme Court and four weeks later, Latney was granted habeas corpus relief in the federal courts.[42] Although it is by no means evident from the opinion itself that the Court of Military Appeals in *Averette* relied on *O'Callahan* and its interpretation in *Latney*, the court did state that "[a]s a result of the most recent guidance in this area from the Supreme Court we believe that a strict and literal construction of the phrase 'in time of war' should be applied."[43] As *O'Callahan* is the only significant Supreme Court decision "in this area" handed down between the time that *Latney* and *Averette* were decided by the Court of Military Appeals, it must be assumed that the court was referring to *O'Callahan*.

Although *O'Callahan* was concerned with military jurisdiction over a *serviceman* within the territorial limits of the United States *in time of peace*,[44] it arguably has some effect on court-martial jurisdiction over civilians such as Averette. The *O'Callahan* decision drastically limited traditional military jurisdiction by requiring, *inter alia*, that the offense be "service-connected" before military jurisdiction can be exercised.[45] In *O'Callahan* Justice Douglas commenting upon the *Reid-Singleton-Grisham-McElroy* line of cases[46] wrote that "[t]hese cases decide that courts-martial have no jurisdiction to try those who are not members of the Armed Forces, no matter how intimate the connection between their offense and the concerns of military discipline."[47] Although the circuit court in *Latney* noted that Justice Douglas failed to mention that "these cases" dealt solely with *peacetime* jurisdiction under article 2(11), not *wartime* jurisdiction under article 2(10), it felt that

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[41] 395 U.S. 258 (1969).
[42] Latney v. Ignatius, 416 F.2d 821 (D.C. Cir. 1969) (per curiam).
[43] 19 U.S.C.M.A. at 365, 41 C.M.R. at —.
[44] 395 U.S. 258, 273 (1969).
[45] *Id.* For a concise discussion of the *O'Callahan* case see Note, *Military Law—Jurisdiction of Courts-Martial to Try Servicemen for Civilian Offenses*, 48 N.C.L. REV. 380 (1970).
[46] *See* cases cited note 23 *supra*.
[47] 395 U.S. 258, 267 (1969) (dictum).

> [i]t is fair to conclude that the *spirit of O'Callahan, and of the other Supreme Court precedents there reviewed, precludes an expansive view of Article 2(10) . . . even assuming as we do that this is a time of undeclared war which permits some invocation of the war power under which Article 2(10) was enacted.* We think Article 2(10) may not be read so expansively as to reach this civilian seaman, employed by a private shipping company, and in no closer physical proximity or duration to the armed forces than a seaman in port for a short period, living on his ship and under the discipline of his civilian captain while waiting for it to turn around, not assimilated to any military personnel in terms of living quarters or conditions, who had been arrested for a [non service-connected] crime committed in a bar frequented by civilians in port.[48]

Thus it can be seen that the federal court in *Latney* did not feel that *O'Callahan* demanded a "strict and literal construction of the phrase 'in time of war' " as did *Averette.* Instead, the court interpreted *O'Callahan* as intimating that before article 2(10) jurisdiction can be constitutionally applied the military must first show an intimate connection between the military and the accused. Such an analysis shifts the emphasis from the "time of war" requirement to more relevant policy considerations, and suggests a more pragmatic approach than that used in *Averette* for determining the jurisdictional bounds of article 2(10). The better approach would seem to require that three conditions coexist in order for jurisdiction under article 2(10) to vest in a time of undeclared war: (1) that there be an intimate connection between the accused and the military; (2) that the offense be service-connected in the sense that it in some way significantly affects military authority, security, or property; and (3) that the traditional broad view of "in the field"[49] be limited to the area of actual hostilities.

Such an approach appears to be warranted and can be supported by

[48] 416 F.2d at 823 (emphasis added).

[49] Hines v. Mikell, 259 F. 28 (4th Cir.), *cert. denied,* 250 U.S. 645 (1919). The court, distinguishing "in the field" from "in the theater of operations," observed that the question of whether or not an armed force is "in the field" "is not to be determined by the locality in which the army may be found, but rather by the activity in which it may be engaged at any particular time." *Id.* at 34. The court thus found that a stenographer employed by the Army at a temporary training camp in the United States was "in the field" during World War I. Similarly, a merchant ship and crew have been held to be "in the field." McCune v. Kilpatrick, 53 F. Supp. 80 (E.D. Va. 1943); *Ex parte* Gerlach, 247 F. 616 (S.D.N.Y. 1917). See W. AYCOCK & S. WURFEL, MILITARY LAW UNDER THE UNIFORM CODE OF MILITARY JUSTICE 57-58 (1955).

precedent. As was noted the existence of war in the context of all military codes has been determined by the realities of the situation, not by the presence of a formal declaration by Congress. Secondly, while recognizing the constitutional power of Congress to provide for wartime military jurisdiction over civilians, the Court in *Reid* seemed to call for a restriction of this jurisdiction to the actual area of hostilities by stating that "[t]he exigencies which have required military rule on the battlefront are not present in areas where no conflict exists."[50] Finally, the general spirit of the *Reid* line of cases and the further limit placed on court-martial jurisdiction by *O'Callahan* would appear to require a direct and intimate connection between the military, the accused, and the crime.

The suggested analysis necessitates an examination of the underlying policy considerations and a balancing of the competing interests of the individual and the military. Obviously, the purpose behind article 2(10) is to insure that the military effectively functions under wartime conditions with a minimum of interference from its civilian component. In an area of actual hostilities, military commanders should have adequate powers to swiftly and effectively deal with those—both civilians and servicemen—who significantly threaten the morale, discipline, or security of American personnel in the war zone. In a situation such as Vietnam the necessity of article 2(10) jurisdiction is vividly portrayed. The combat readiness of our troops, and hence the lives of many Americans, can be severely jeopardized if the military has no effective means of dealing with such problems as the sale of illegal drugs, prostitution, blackmarket operations, unauthorized dealings with the enemy, and numerous petty crimes.[51] Such crimes are more easily perpetrated by those who are directly connected with the military operations. A trial by a civil court, if available, does not provide the swift discipline and strong deterrence necessary to the military effort.

An additional consideration—that of the "jurisdictional gap"—is also pertinent here. While it is constitutionally permissible to try citizens in a United States court for crimes committed outside the territorial limits

[50] Reid v. Covert, 354 U.S. 1, 35 (1957). The Court also declared that "[f]rom a time prior to the adoption of the Constitution the extraordinary circumstances present in an area of actual fighting have been considered sufficient to permit punishment of some civilians *in that area* by military courts under military rules." *Id.* at 33 (emphasis added).

[51] *See, e.g.*, United States v. Burney, 6 U.S.C.M.A. 776, 798-800, 21 C.M.R. 98, 120-22 (1956).

of the United States,[52] generally, only crimes against the Government are cognizable.[53] On the other hand, extraterritorial crimes against private individuals or their property (*i.e.*, assault, murder, and larceny) are not cognizable in federal courts.[54] Fortunately, a crime such as Averette's would be triable in a United States district court although such a trial would be plagued with lack of power to compel the attendance of foreign witnesses, tremendous expense, and fantastic waste.[55] However, in *Averette* the court's "time of war" holding was not limited to such offenses, and apparently would apply to murder abroad and numerous other crimes not triable in the United States courts. For such offenses the only acceptable alternative may well be to turn the accused over to the appropriate foreign government where he would enjoy no United States constitutional rights, hoping that the foreign government will be interested enough to prosecute, yet detached enough to give a fair trial.

Of necessity military trials do not provide the full array of constitutional safeguards that are inherent in the article III courts. However, the exigencies of wartime justify some restrictions on the rights of civilians who are intimately connected with the military operation. Indeed, this is the central idea behind the constitutional provisions for special war powers. The "formal declaration test" set forth by the Court of Military Appeals, while providing an objective test for determining at what point jurisdiction vests, ignores both the rationale for such jurisdiction, and the fact of modern international life that most shooting wars rage on without de jure declaration. The proposed test is more flexible and would require the court to look at underlying policy considerations. It does not indiscriminately include or exclude a civilian. Unwarranted encroachment upon the civilian's constitutional rights is protected, but if the needs of national military policy are adequately shown then jurisdiction vests.

THOMAS R. CRAWFORD

[52] U.S. CONST. art. III, § 2; 18 U.S.C. § 3238 (1964).
[53] United States v. Bowman, 260 U.S. 94 (1922).
[54] *Id.* at 98.
[55] *See, e.g.*, United States v. Burney, 6 U.S.C.M.A. 776, 802-03, 21 C.M.R. 98, 124-25 (1956).

Municipal Corporations—Zoning—Good Faith Expenditures in Reliance on Building Permits as a Vested Right in North Carolina

Zoning has long been recognized as a constitutionally valid exercise of a state's police power;[1] however, the exercise of this power has resulted in considerable controversy in cases in which a zoning ordinance is enacted subsequent to the issuance of a building permit upon which the permittee has relied.[2] In *Town of Hillsborough v. Smith*,[3] the defendants, having acquired an option on a lot, obtained a building permit to construct a dry cleaning establishment. After the permit was issued, the defendants exercised their option, signed a fifteen thousand dollar building contract, and ordered a considerable amount of business equipment. Five days later the town enacted a zoning ordinance restricting for residential use an area which included the defendants' property. The defendants continued to make expenditures until they received a letter revoking their building permit and were shown a copy of the enacted ordinance. Despite the revocation, they later commenced construction on the lot.[4] When the town sought to enjoin further work, the defendants answered that since they had made good faith expenditures in reliance on the building permit, without notice of the pending ordinance, they had acquired a vested right to complete construction.[5]

Although the trial court found in favor of the defendants,[6] the North Carolina Court of Appeals granted a new trial on the grounds of an erroneous jury instruction.[7] The North Carolina Supreme Court, reversing, affirmed the trial court's verdict.[8] The court reasoned that all expenses incidental to the construction that were incurred prior to the effective date of the zoning ordinance would create a vested right to complete construction if the expenses were substantial in nature and made

[1] 8 E. McQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 25.05 (3d ed. 1965) [hereinafter cited as McQUILLIN]; *see, e.g.*, Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926); McKinney v. City of High Point, 239 N.C. 232, 79 S.E.2d 730 (1954).

[2] *See generally* 9 McQUILLIN §§ 26.200-.227; 1 E. YOKLEY, ZONING LAW AND PRACTICE §§ 9-5 to -9 (3d ed. 1965) [hereinafter cited as YOKLEY].

[3] 276 N.C. 48, 170 S.E.2d 904 (1969).

[4] *Id.* at 50, 170 S.E.2d at 906.

[5] Record at 4, Town of Hillsborough v. Smith, 276 N.C. 48, 170 S.E.2d 904 (1969).

[6] The trial court judge framed the issue for the jury as being whether "the defendants, in good faith, and without notice of the pending zoning ordinance prohibiting the use of their property for business purposes, incur[red] substantial expenses in reliance upon the building permit issued to them on May 3, 1968[.]" *Id.* at 30.

[7] 4 N.C. App. 316, 167 S.E.2d 51 (1969).

[8] 276 N.C. 48, 170 S.E.2d 904 (1969).

in good faith reliance on the building permit.[9] Despite conflict in the testimony, the jury's verdict was held to be conclusive on the issues of the defendant's good faith and lack of notice of the pending ordinance.[10] The court further held that substantial expenditures had been made and therefore a vested right had accrued in favor of the permittee.

The theory of vested rights accruing from reliance on a building permit is closely related to the doctrine of nonconforming use.[11] A nonconforming use has been defined as "[a] structure or land lawfully occupied by a use that does not conform to the regulations of the district in which it is situated."[12] Such a use existing when a zoning ordinance is enacted that prohibits or restricts that particular use in effect becomes a vested right and, as a general rule, may be continued.[13] This vested right theory has not only been applied to a nonconforming use when construction was incomplete before the passage of the restrictive ordinance, but also to building permits when substantial expenditures have been made in good faith reliance on the permit.[14]

Before resolving the issue of whether a permittee's expenditures are substantial, the court must initially ascertain the elusive element of good faith. Although the majority of jurisdictions insist upon good faith where expenditures are made in reliance upon building permits,[15] apparently there is no definite formula for its measure. A New York case concluded that one method of ascertaining good faith was the large amount of money

[9] *Id.* at 55, 170 S.E.2d at 909 (1969).

[10] *Id.* at 56, 170 S.E.2d at 912-13.

[11] 8 McQUILLIN § 25.157.

[12] P. GREEN, ZONING IN NORTH CAROLINA 127 (1952). Another authority's definition is "a lawful use existing on the effective date of the zoning restriction and continuing since that time in nonconformance to the ordinance." 2 YOKLEY § 16-2.

[13] *See* 8-A McQUILLIN §§ 25.180-.188.

[14] *Id.* § 25.181. The idea of a vested right arising from expenditures in good faith reliance on a building permit is considered a property right of the sort guaranteed in the Constitution. Willis v. Woodruff, 200 S.C. 266, 20 S.E.2d 699 (1942). Another argument permittees use is the doctrine of equitable estoppel, which forbids a municipality to revoke a building permit after the permittee has made substantial expenditures in reliance on the permit. *See, e.g.*, Township of Pittsfield v. Malcolm, 255 Iowa 761, 124 N.W.2d 166 (1965) (dog kennel had been built under a permit at a cost of forty-five thousand dollars; a delay of ten months before injunction was sought created equitable estoppel). There are many states, however, that do not allow equitable estoppel to apply to a municipality. *E.g.*, City of Gastonia v. Parrish, 271 N.C. 527, 157 S.E.2d 154 (1967). For a more detailed discussion of the applications of equitable estoppel to building permit denials, see 9 McQUILLIN §§ 26.213, 27.56; 1 YOKLEY § 10-8; Note, *Revoked Building Permits and Equitable Estoppel in Florida*, 15 U. FLA. L. REV. 418 (1962).

[15] 9 McQUILLIN § 26.219; 1 YOKLEY § 9-5; 101 C.J.S. *Zoning* § 243 (1958).

spent by the permittee in reliance on the legality of his permit.[16] Another New York decision held that surveys and paper work over an eight month period was sufficient indication of a property owner's good faith, even though construction was not commenced until one month before a zoning ordinance was amended to prohibit the intended use.[17] On the other hand, where a permittee possessed only an option on a tract of land, knowledge of open neighborhood hostility and delay in construction resulted in an adjudication of bad faith.[18] Lapse of time between the date of the permit and the date the ordinance becomes effective is frequently relevant on the issue of good faith.[19]

In *Stowe v. Burke*,[20] the North Carolina Supreme Court explicitly made good faith a requirement for acquiring a vested right where there is reliance upon a building permit. The evidence showed that the owner actually knew of the pending ordinance and the hostility of his neighbors to the proposed use. An expenditure of over fifty-five thousand dollars on foundation work ten days before the ordinance took effect could not create a vested right absent good faith.[21] Thus, although amount of money expended may be an indication of good faith, it is not the sole criteria and will be rejected if there are other signs that point to bad faith.

Knowledge of hostility was also present in *Warner v. W & O, Inc.*,[22] in which neighbors filed a petition for rezoning the day after the optionee obtained a building permit. Although the permit holder knew of the pending zoning ordinance, he exercised his option on the property and had several trees removed before the ordinance became effective. On the question of good faith, the court stated that the law would not help anyone expending money for a known illegal purpose, nor "one who waits until after an ordinance has been enacted forbidding the proposed use and . . .

[16] Pelham View Apts., Inc. v. Switzer, 130 Misc. 545, 224 N.Y.S. 56 (Sup. Ct. 1927) (plaintiff, in reliance on a permit, bought land, hired an architect, executed a mortgage and excavated the cellar); *accord*, Glenel Realty Corp. v. Worthington, 4 App. Div. 2d 702, 164 N.Y.S.2d 635 (1957).

[17] Miller v. Dassler, 155 N.Y.S.2d 975 (Sup. Ct. 1956).

[18] Miami Shores Village v. Wm. N. Brockway Post, 156 Fla. 673, 24 So. 2d 33 (1945) (en banc); *accord*, Graham Corp. v. Board of Zoning Appeals, 140 Conn. 1, 97 A.2d 564 (1953) (knowledge of hostility and hurried expenditures before ordinance enacted evidence of bad faith).

[19] Williams v. Village of Deer Park, 78 Ohio App. 231, 69 N.E.2d 536 (1946) (permit granted one day before lot annexed to city with prohibitive ordinance).

[20] 255 N.C. 527, 122 S.E.2d 374 (1961).

[21] *Id.* at 533, 122 S.E.2d at 378. The findings of fact allowed the trial judge to conclude as a matter of law that the defendant had acted in bad faith.

[22] 263 N.C. 37, 138 S.E.2d 782 (1964).

hastens to thwart the legislative act by making expenditures a few hours prior to the effective date of the ordinance . . . ."[23]

It seems unlikely that the permittee in *Smith* should win in light of the decisions in *Stowe* and *Warner*. The cases serve to highlight that proper resolution of the factual controversy is critical to the issue of good faith. Proof that the defendant had notice of the proposed zoning ordinance upon receiving his permit would have precluded the defense of good faith reliance. Had there been no factual dispute, the trial judge could have determined the issue of good faith as a matter of law.[24] Ultimately, the jury decided the question as one of fact with no firm guidelines as to what constituted good faith. The court did state that a conscious race with the city to make expenditures before a prohibitive zoning ordinance is adopted shows a lack of good faith.[25] However, the court did not explain how this "race" can be recognized, nor did it specifically discuss the relevancy of time as a factor in determining its existence.

Closely associated with the issue of good faith is the element of notice.[26] Some jurisdictions limit a permittee's opportunity to create a vested right by declaring that no right will ensue if the permittee has actual or constructive knowledge of the pending ordinance.[27] In North Carolina, if the permittee makes expenditures when he has actual knowledge of a pending ordinance, such action is apparently a sign of bad faith.[28] However, the precise effect of constructive notice is unclear. In *Stowe*, there was evidence that the permittee received written notice of the hearing to be held on the zoning ordinance. In addition, advertisements appeared in the local newspaper, and the hostility of surrounding property owners did not go unconcealed.[29] In *Warner*, the ordinance was adopted

[23] *Id.* at 43, 138 S.E.2d at 787.

[24] For further information about the testimony, see Record at 13-26, Town of Hillsborough v. Smith, 276 N.C. 48, 170 S.E.2d 904 (1969).

[25] 276 N.C. at 56, 170 S.E.2d at 910.

[26] As in *Stowe* and *Warner*, the trial judge properly instructed the jury in *Smith* that expenditures must be made in good faith "without knowledge of the pending ordinance." Record at 30, 276 N.C. 48, 170 S.E.2d 904 (1969).

[27] 1 YOKELY § 9-7; *see, e.g.*, Sharrow v. City of Dania, 83 So. 2d 274 (Fla. 1955) (permit was subject to revocation despite expenditures in reliance when proposed ordinance had been heard on first reading before adoption by city council); *accord*, Tuscon v. Arizona Mortuary, 34 Ariz. 495, 272 P. 923 (1928) (no vested right to build when informed before major construction that ordinance affecting land is contemplated). *Contra*, Yocum v. Power, 398 Pa. 223, 157 A.2d 368 (1960) (unpassed city council ordinance has no governmental authority). See Note, 15 U. FLA. L. REV. 418, *supra* note 14.

[28] Warner v. W & O, Inc., 263 N.C. 37, 138 S.E.2d 782 (1964); Stowe v. Burke, 255 N.C. 527, 122 S.E.2d 374 (1961).

[29] 255 N.C. at 533, 122 S.E.2d at 378.

before any construction started, and the permit holder was well aware of neighborhood opposition to the proposed use.[30] In *Smith*, however, none of these factors was clearly present. The defendant admitted hearing vague talk of a proposed ordinance, but did not believe that it affected him.[31] The town argued that publication of the notice of the hearing imparted constructive knowledge of the pending ordinance;[32] hence, they urged that Smith should not be allowed to account for expenditures made after the date of publication. The court, however, held that all expenditures were valid until the effective date of the ordinance and that a jury verdict of no notice was conclusive.[33] The concept of sufficient notice thus remains confused. The confusion could have been considerablly reduced if the court had explicitly stated its views on constructive notice. Arguably, *Smith* stands for the proposition that newspaper advertisements stating that a public hearing is to be held on a pending zoning ordinance do not impart constructive notice such as will bar a finding of good faith. The court has probably made the better choice here by allowing the jury to hear evidence of constructive notice, without declaring it bad faith as a matter of law.

After resolving the issues of good faith and notice, another problem remains: how does the court determine what constitutes substantial expenditures? Most jurisdictions hold that a building permit alone does not create a vested right[34] but that the landowner must make substantial expenditures or incur substantial obligations in reliance on the building

[30] 263 N.C. at 41, 138 S.E.2d at 785.
[31] Record at 19, 22, 276 N.C. 48, 170 S.E.2d 904 (1969).
[32] Brief for Apellant at 7, 11, 4 N.C. App. 316, 167 S.E.2d 51 (1969).
[33] 276 N.C. at 56, 170 S.E.2d at 910
[34] 8 McQUILLIN § 25.156; 101 C.J.S. *Zoning* § 243 (1958); *see, e.g.*, Graham Corp. v. Board of Zoning Appeals, 140 Conn. 1, 97 A.2d 564 (1953); Roselle v. Moonachie, 49 N.J. Super. 35, 139 A.2d 42 (Super. Ct. 1958). *Contra*, Yocum v. Power, 398 Pa. 223, 157 A.2d 368 (1960) (permit for church issued under existing law could not be revoked because of pending proceedings to prohibit use); Shapiro v. Zoning Board of Adjustment, 377 Pa. 621, 105 A.2d 299 (1954) (issuance of permit allowed right to vest); Hull v. Hunt, 53 Wash. 2d 125, 331 P.2d 856 (1958) (lack of expenditure or change of position did not invalidate permit; right vests on application for permit if thereafter issued). Indeed, one authority suggests that some recent cases show a trend of allowing a right to vest if reliance expenditures are made pending issuance of a building permit. 1 YOKLEY § 9-5 at 409 (citations omitted). *Contra*, Spur Distributing Co. v. City of Burlington, 216 N.C. 32, 3 S.E.2d 427 (1939) (permit denied where the ordinance was enacted during consideration of the permit application). North Carolina followed the majority rule in Warner v. W & O, Inc., 263 N.C. 37, 41, 138 S.E.2d 782, 785 (1964), holding that "[t]he permit created no vested right; it merely authorized permittee to act."

permit.[35] The Town of Hillsborough argued that the test for establishing a substantial expenditure is whether or not actual construction has begun.[36] Rejecting this contention, the court adopted the majority rule as stated by the New Hampshire Supreme Court in *Winn v. Lamoy Realty Corp.*:[37] "the better view . . . is that where an owner, relying in good faith upon a permit and before it has been revoked, has made substantial construction on the property *or has incurred substantial liabilities*, relating directly thereto . . . the permit may not be cancelled."

In deciding a substantial expenditure question, two factors must be kept in mind—what type of expenditure will be considered, and how much expenditure is substantial. In a case prior to *Smith* in which business equipment was purchased and placed at the site of a proposed service station, the North Carolina Supreme Court admitted this evidence and allowed the jury to determine whether these expenditures were substantial.[38] Apparently, an expenditure of this type was one the court would allow a jury to consider in reaching their verdict. The decision in *Warner* hinged on the absence of the property owner's good faith, but had language indicating that incidental expenditures as opposed to actual construction, are relevant to the resolution of a vested rights question. The court in *Warner* carefully examined the facts—that an architect's drawing completed before issuance of the building permit was not contracted for in reliance on it, that a contract to purchase land that was voidable would not create a vested right, and that the removal of several trees before the ordinance took effect was not substantial construction.[39] Presumably, if the contract had been binding, and the drawings made in reliance, those expenses would have been considered.[40]

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[35] 8 McQUILLIN § 25.157; 9 *Id.* § 26.219; 1 YOKLEY § 9-5.

[36] Brief for Appellant at 11, 4 N.C. App. 316, 167 S.E.2d 51 (1969). This is the minority rule. *See, e.g.*, Kiges v. City of St. Paul, 240 Minn. 582, 62 N.W.2d 363 (1953).

[37] 100 N.H. 280, 281, 124 A.2d 211, 213 (1956) (emphasis added) (no vested rights acquired where expenses and obligations were very small in relation to the total cost of the proposed building). The rule was followed in North Carolina although it was used more to advocate a good faith requirement than to articulate a position on substantial expenditures. See Stowe v. Burke, 255 N.C. 527, 122 S.E.2d 374 (1961).

[38] *In re* Rose Builder's Supply Co., 202 N.C. 497, 163 S.E. 462 (1932).

[39] 263 N.C. at 41-42, 138 S.E.2d at 785.

[40] In *In re* Tadlock, 261 N.C. 120, 134 S.E.2d 177 (1964), the court would not allow the plaintiff to enlarge a trailer park, part of which had been completed before an ordinance prohibiting the use was adopted, because the enlargement was still in the planning stage. This case was decided on the basis of a nonconforming use since a building permit had never been issued. Presumably, the same result

Although the North Carolina Supreme Court has noted with approval the majority rule pertaining to substantial expenditures, *Smith* is apparently the first case to face squarely the issue of what types of expenditures will be considered in creating a vested property right. The court explicitly stated that they found no difference between expenditures resulting in physical changes to the land itself, and expenditures made for construction materials, equipment, or for contracts for construction or equipment.[41] Although the court in *Warner* held it unnecessary for a permittee to complete construction before the ordinance took effect,[42] in *Smith*, the court sets forth more complete guidelines for permit holders attempting to acquire a vested right to complete construction on the basis of substantial expenditures. In considering the amount expended and the nature of the obligations incurred, rather than physical change in the land itself, the jury is allowed to arrive at a more equitable determination of whether substantial expenditures have actually occurred.[43]

By holding that binding contractual obligations made in good faith reliance will be considered as substantial expenditures,[44] the court may have created an additional problem in determining what constitutes a binding obligation. In *Warner*,[45] the contract to purchase property was not considered a valid expense because it was voidable. *Smith* may make it necessary for a court to make an initial determination of the enforceability of the contracts involved in order to reach the substantial expenditure question.

The court in *Smith* detailed the types of expenditures that will be

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of not allowing completion of one stage to create a vested right for construction of further stages will also apply to the situation in which the landowner has relied on a building permit to complete the first stage.

[41] 276 N.C. at 55, 170 S.E.2d at 909.

> It is not . . . a change in the appearance of the land, which creates the vested property right in the holder of the permit. The basis of the right to build and use his land, in accordance with the permit issued to him, is his change of his own position in bona fide reliance upon the permit.

Id.

[42] 263 N.C. at 41, — 138 S.E.2d at 785.

[43] Ohio, Pennsylvania and Washington are among the minority of states that do not consider expenses, holding that the vested right accrues upon application for the permit if it should have been later issued. *See, e.g.*, Gibson v. City of Oberlin, 171 Ohio St. 1, 167 N.E.2d 651 (1960); Yocum v. Power, 398 Pa. 223, 157 A.2d 368 (1960); Hull v. Hunt, 53 Wash. 2d 125, 331 P.2d 856 (1958). For a more thorough discussion of the Ohio position, see Note, *Municipal Corporations—Zoning—Law at Time of Application for Building Permit Controlling*, 30 U. CIN. L. REV. 380 (1961). *See also* Note, 15 U. FLA. L. REV. 418, *supra* note 14.

[44] 276 N.C. at 54, 170 S.E.2d at 909.

[45] 263 N.C. at 42, 138 S.E.2d at 785.

allowed as evidence of substantial expenditure; however, the question of what dollar amount is required to make these expenditures substantial was not fully discussed. Although the issue is normally left to the jury, the court indicated that the mere purchase of property, no matter what the cost, will not suffice.[46] Thus, the jury is left with almost unlimited latitude in determining the dollar amount of expenditure necessary for the creation of a vested right. Perhaps a better solution than leaving so much discretion with the jury would be to establish a certain minimum percentage of the estimated total cost of building as the necessary requirement for a vested right to complete construction. The main disadvantage in establishing a fixed minimum percentage is readily observed when one considers large-scale enterprises. Such undertakings would be required to expend greater sums in order to satisfy the percentage requirement. If they fall short, the right to complete construction is lost. Meanwhile, less expansive enterprises can easily satisfy the requirement with a proportionately smaller expenditure, thus acquiring a vested right to complete construction. A suggested minimum percentage would, however, provide a useful rule-of-thumb in many instances.

Despite some unanswered questions, the area of vested rights is now much clearer in North Carolina. A permittee now knows that money expended on anything incidental to the proposed use—building contracts, equipment, purchase money—will be allowed as evidence of substantial expenditures, a position that prior cases have only intimated. Whether the court must now determine the enforceability of contracts as part of the test of substantial expenditures is unclear. Exactly how much of the total cost of construction must be expended before the vested right accrues is left to the jury's discretion and will probably change with each set of facts. In any event, it is safe to predict that future permittees will have an easier task in acquiring a vested right.

ELIZABETH LYNNE POU

Securities Regulation—Allowance of Attorneys' Fees in 14(a) Derivative Suits

With the recognition of an implied private right of action under section 14(a) of the 1934 Securities Exchange Act,[1] individual shareholders

[46] 276 N.C. 55, 170 S.E.2d at 909.

[1] Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (1964) [hereinafter cited as 14(a)], provides:

became potentially important agents in the enforcement of federal proxy rules and policy.[2] Indeed, the court in *J. I. Case Co. v. Borak* considered such private enforcement "a necessary supplement" to government action.[3] This private enforcement may take the form of a shareholder derivative suit;[4] but such suits are particularly costly, and recovery is generally had by the corporation exclusively.[5] Recognizing this, the Supreme Court in *Mills v. Electric Auto-Lite Co.*[6] made an interim award of attorneys' fees to successful plaintiff-shareholders when they established a management violation of the federal proxy rules.

In *Mills*, plaintiff-shareholders brought an action under 14(a) and Securities Exchange Commission rule 14a-9[7] promulgated thereunder.[8]

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title.

[2] J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

[3] *Id.* at 432.

[4] Derivative and direct actions may be brought under 14(a) by private parties. *Id.* at 431.

[5] *See, e.g.*, Keenan v. Eshleman, 23 Del. Ch. 234, 2 A.2d 904 (Sup. Ct. 1938).

[6] 396 U.S. 375 (1970).

[7] SEC Rule 14a-9, 17 C.F.R. § 240.14a-9 (1970), provides:

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statement therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(b) The fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the Commission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders. No representation contrary to the foregoing shall be made.

The plaintiffs in *Mills* asserted that their action was derivative and on behalf of all minority shareholders as a class. 403 F.2d 429, 431 (7th Cir. 1968).

[8] Plaintiffs alleged that management had carried on a materially misleading proxy solicitation which resulted in shareholder approval of a proposed corporate merger. Plaintiffs sought to set aside the merger. The district court held the proxy solicitation to be materially misleading, and the Seventh Circuit agreed, but decided if management could show the merger would have occurred in any event, plaintiffs

No question of attorneys' fees was presented in the lower courts,[9] but when *Mills* reached the Supreme Court the issue was injected into the litigation by the federal government as amicus curiae.[10] The government maintained that once a violation of 14(a) had been established, plaintiff-shareholders should be entitled to litigation expenses, including reasonable attorneys' fees, to "enable them to go forward with the trial on the issue of appropriate relief and . . . for their efforts in establishing the violation."[11] The government contended that private actions under 14(a) would be "seriously inhibited" if such fees were not awarded.[12] The government thus requested the Court to decide in favor of two awards: the first for the expense of establishing the 14(a) violation; the second for the future expense of litigating the remanded relief issue.[13] Surprisingly, the corporate defendant did not contest the proposition that attorneys' fees should be awarded successful plaintiff-shareholders in 14(a) litigation. Instead, it chose to stress its particular situation as militating against such an award.[14]

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would be entitled to no relief. Moreover, the Seventh Circuit held management need only show that the merger was fair to establish that it would have occurred in any event. The Supreme Court held that since plaintiffs had shown the proxy statements to be materially misleading, no actual effect on the voting process need be demonstrated to entitle plaintiffs to relief. While not deciding what, if any, relief should be given, the Court stated that plaintiffs' cause of action was established under the federal proxy rules; to hold otherwise would discourage necessary private actions and substitute judicial judgment for shareholder judgment as to the desirability of management proposals. In this posture, the case was remanded on the issue of relief. For a discussion of the materiality problem in *Mills* see, Note, *Shareholder Derivative Suits Under Rule 14a-9*, 49 N.C.L. REV. 215 (1970).

[9] The district court opinion is reported at 281 F. Supp. 826 (N.D. Ill. 1967); the circuit court opinion is reported at 403 F.2d 429 (7th Cir. 1968).

[10] The amicus brief was filed by the Justice Department in October 1969, however, SEC counsel participated in its preparation.

[11] Brief for the United States as Amicus Curiae at 19, Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970).

[12] *Id.* at 11.

[13] In asking the Court to decide whether plaintiffs should be entitled to recover attorneys' fees for future litigation on the issue of relief, the government recognized the potential for abuse and suggested that plaintiffs be required to show a substantial possibility that defendants' proof of fairness might be successfully controverted. *Id.* at 21. The Court, however, declined to decide whether plaintiffs would be entitled to an award for future expenses. That decision was reserved for the lower courts after trial could be had on the relief issue. 396 U.S. 375, 390 n.13 (1970).

[14] Basically, the corporate defendant contended that the plaintiff-shareholders had *deliberately* chosen to withhold their complaint until after the merger and that an award of attorneys' fees in such a case would "encourage plaintiffs to lie in wait until it is too late to rectify alleged deficiencies [in the proxy material] . . . ." On the other hand, the defendant stressed that had suit been brought before the share-

As a general rule, litigants may not recover attorneys' fees absent specific statutory authorization or contractual agreement.[15] An exception to this rule has developed in derivative suits, however, where a fee award is now generally held recoverable if the successful shareholder's suit has "substantially benefited" the corporation.[16] Courts have traditionally recognized that it is inequitable for one party to bear the entire expense of securing a group benefit.[17] This equitable recognition is firmly grounded in the policy against unjust enrichment.[18] An early illustration of its operation is creditor litigation where often one creditor would procure or protect funds out of which other creditors found satisfaction. In such cases courts have uniformly held that it is only fair that the benefited creditors share the litigation expenses.[19] Corporate derivative suits are particularly suited for such treatment since derivative theory envisions plaintiff-shareholders as champions defending the rights of their corporation.[20] The totality of shareholders is generally recognized as constituting the corporation,[21] and since it is the corporation that recovers in a successful derivative suit,[22] then logically litigation expenses should be apportioned among all the shareholders. This apportionment can be mechanically accomplished by an award of attorneys' fees against the corporation.[23]

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holder meeting the proxy statements could have easily been corrected, or if necessary, the meeting could have been postponed. Had such been the case, the corporate defendant submitted, "[a]warding of attorneys' fees . . . would serve as an additional incentive to prompt assertion of claimed violations of the Proxy Rules." Brief for Respondents at 29-33, Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970).

[15] *E.g.*, Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 717 (1967).

[16] *See, e.g.*, Bosch v. Meeker Co-op Light & Power Ass'n, 257 Minn. 362, 101 N.W.2d 423 (1960).

[17] *See, e.g.*, Sprague v. Ticonic Nat'l Bank, 307 U.S. 161 (1939); Trustees v. Greenough, 105 U.S. 527 (1881).

[18] It has also been suggested that where one party secures a judgment benefiting a group, that party may have acquired an implied representative status whereby he was authorized by the group to retain counsel and proceed to judgment. Another theory holds that property which has been secured by an attorney's services should bear the cost thereof. *See*, Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658 (1956).

[19] *See, e.g.*, Trustees v. Greenough, 105 U.S. 527 (1881); *In re* Williams, 29 F. Cas. 1324, 1325 (No. 17704) (C.C.D.S.C. 1868).

[20] *See, e.g.*, Dodge v. Woolsey, 59 U.S. (18 How.) 331 (1855).

[21] State *ex rel.* Weede v. Bechtel, 244 Iowa 785, 806, 56 N.W.2d 173, 187 (1952).

[22] *Id.*

[23] An interesting question to consider is whether in 14(a) litigation the corpo-

Yet, on the other hand, it would seem most undesirable if attorneys' fees against the corporation were awarded plaintiff-shareholders in every derivative suit. Since one major policy underlying such awards is unjust enrichment, the corporation must, at the very least, be enriched. Early cases required an enrichment taking the form of a "pecuniary benefit,"[24] but the modern view holds a "substantial benefit" will suffice.[25] The difficulty today is discovering what benefits will be deemed substantial; modern cases display much uncertainty. In *Saks v. Gamble*,[26] for instance, the defendant corporation withheld information concerning its ownership of a second corporation. Shareholders, unaware of the ownership, brought a derivative action for diversion of corporate opportunities. Thereafter, the defendant corporation disclosed its ownership and was held to have substantially benefited thereby.[27] On the other hand, shareholders successfully precluded directors from serving competing corporations simultaneously in *Schechtman v. Wolfson*,[28] but were held *not* to have substantially benefited their corporation.[29] In *Bosch v. Meeker Co-op Light and Power Association*,[30] the Minnesota Supreme Court held that the determination of substantial benefit is for the trial court but enunciated this guide for the lower courts to follow:

> [A] substantial benefit must be something more than technical in its successful conseqeuence and be one that accomplishes a result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affects the enjoyment or protection of an essential right to the shareholder's interest.[31]

One fairly clear condition precedent to a finding of substantial benefit is a court victory by the pliantiff-shareholder.[32] Not infrequently, how-

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ration should have the right to go against the directors who are responsible for the 14(a) violation. If such right of action exists, then the question would arise as to whether the directors would have the right to be indemnified by the corporation. If such be the case, then the corporation's attempt to hold the directors liable is useless.

[24] *See, e.g.*, Trustees v. Greenough, 105 U.S. 527 (1881).

[25] Bosch v. Meeker Co-op Light & Power Ass'n, 257 Minn. 362, 101 N.W.2d 423 (1960). *See also* Note, *Shareholder Suits: Pecuniary Benefit Unnecessary for Counsel Fee Award*, 13 STAN. L. REV. 146 (1960).

[26] 38 Del. Ch. 504, 154 A.2d 767 (Ch. 1958).

[27] *Id.* at 507, 154 A.2d at 770.

[28] 244 F.2d 537 (2d Cir. 1957).

[29] *Id.* at 540.

[30] 257 Minn. 362, 101 N.W.2d 423 (1960).

[31] *Id.* at 366-67, 101 N.W.2d at 426-27.

[32] State *ex rel.* Weede v. Bechtel, 244 Iowa 785, 810, 56 N.W.2d 173, 198 (1952).

ever, management will render a pending case moot by performing essentially as the complaint demands prior to trial.[33] In such cases, attorneys' fees may still be awarded if the plaintiff-shareholder can show a causal relationship between the beneficial management performance and the institution of the derivative suit.[34] In *Kahan v. Rosenstiel*,[35] the court held that if attorneys' fees were to be awarded after the suit had been rendered moot, there must be some demonstration of the meritorious nature of the suit; this merit may be shown by proof that the suit would have withstood a motion to dismiss.[36]

The Court in *Mills* experienced little difficulty finding a substantial benefit. This finding was largely based on congressional policy favoring an informed corporate electorate.[37] Private actions vindicating that policy were described as "corporate therapeutics."[38] Since the finding is based on congressional policy, it is clear that the "substantial benefit" requirement will be satisfactorily met in all derivative actions under 14(a) once plaintiff-shareholders establish a violation of the federal proxy rules. Relying on *Mills*, all plaintiff-shareholders will undoubtedly seek attorneys' fees in 14(a) derivative suits. Presumably the Court could have reached the same result by simply holding federal policy sufficiently strong to necessitate a fee award. Such a holding would have obviated the substantial benefit analysis in *Mills*, but it would seem a proper and logical holding in light of *Borak*.[39]

The mechanical finding of a substantial benefit once the 14(a) violation has been established may be attacked in many cases as illogical. In

[33] *E.g.*, Schechtman v. Wolfson, 244 F.2d 537 (2d Cir. 1957), where suit was brought to break an interlocking board of directors and the board voluntarily unlocked prior to trial; Yap v. Wah Yen Kituk, 43 Hawaii 37 (1958), where suit was brought alleging a corporate loan to be ultra vires and the loan was voluntarily returned prior to final decree; Greenough v. Coeur D'Alenes Lead Co., 52 Idaho 599, 18 P.2d 288 (1932), where suit was brought to compel a director to return certain stock allegedly wrongfully sold him and the stock was voluntarily returned prior to trial.

[34] *See, e.g.*, 244 F.2d 537, 540 (1957), Globus, Inc. v. Jaroff, 279 F. Supp. 807, 809 (1968), Treves v. Servel, Inc., 38 Del. Ch. 483, 154 A.2d 188 (Sup. Ct. 1959).

[35] 300 F. Supp. 447 (D. Del. 1969).

[36] *Id.* at 450.

[37] "[T]he stress placed by Congress on the importance of fair and informed corporate suffrage leads to the conclusion that, in vindicating the statutory policy, petitioners have rendered a substantial service to the corporation and its shareholders." 396 U.S. 375, 396 (1970).

[38] *Id.*

[39] Regarding 14(a), the Court in *Borak* stated that "it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." 377 U.S. 426, 433 (1966).

Mills itself, for instance, management owned a majority of the Electric Auto-Lite stock.[40] If the merger which took place is ultimately held fair, it may be argued that Electric Auto-Lite could not logically be said to have "substantially benefited" from years of costly litigation. One answer to such an argument is as follows: If the vindication of federal law and policy is beneficial, then the question of whether a benefit accrues in actions such as *Mills* is quickly answered in the affirmative. The more difficult question is *who* benefited. Clearly, the enforcement of any public law should produce a public benefit and the the pertinent question is whether this benefit extends to corporations like Electric Auto-Lite. It is submitted that even if Electric Auto-Lite were not directly benefited, it received a substantial indirect benefit in that future proxy solicitations are less likely to include misleading statements. At the very least, management, having paid a heavy price for what was probably a wholly unnecessary nondisclosure, will certainly be made more cognizant of shareholders' rights. This type of benefit is clearly what the federal proxy rules are designed to produce, and the award of attorneys' fees in such actions enhances the viability of those rules. Thus, the Court's finding of a substantial benefit in *Mills* is probably correct, but the analysis could have been avoided by a holding based exclusively on federal policy and *Borak*.

The award of attorneys' fees in derivative suits, however, has not gone without criticism even where a substantial benefit is clear. A number of reasons have been suggested for applying the general rule of no fee awards to derivative litigation. One of these reasons is essentially ethical. It has been argued that the availabiilty of fee awards in 16(b)[41] suits tempts lawyers to engage in champerty.[42] Closely associated with this consideration is the fear that fee awards may increase the presence of "strike suits,"—suits instituted mainly for their nuisance value.[43] It has not been demonstrated, however, that fee awards in derivative suits have substantially increased unethical behavior. Were this shown, it would still be necessary to determine whether the policies against such behavior out-

[40] 396 U.S. 375, 379 (1970). It is interesting to speculate on how the Court in *Mills* would have held had management owned sufficient stock to have rendered the proxy solicitation unnecessary. Presumably in such a case federal policy would indicate a similar substantial benefit analysis, but the good faith of plaintiffs would doubtless be a serious consideration.

[41] Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1964) [hereinafter 16(b)].

[42] *See* 2 L. Loss, SECURITIES REGULATION 1051-54 (2d ed. 1961).

[43] *See* Bosch v. Meeker Co-op Light & Power Ass'n, 257 Minn. 362, 101 N.W.2d 423 (1960).

weigh those in favor of fee awards. The court in *Magida v. Continental Can Co.*[44] was presented with the question of whether alleged champertous conduct on the part of an attorney who brought suit for a plaintiff-shareholder under 16(b) would preclude a fee award. While the court found that the party raising the question had no standing to do so,[45] it nevertheless stated:

> Whatever the ethics of the situation . . . [p]resumably Congress is aware of the opportunity presented to attorneys to finance suits for their benefit, but apparently it regards public policy against . . . violations of fiduciary responsibility by corporate officers at the expense of the public more detrimental to public good than the violation of generally accepted ethics by attorneys.[46]

The court in *State ex rel. Weede v. Bechtel*[47] maintained that since derivative suits are the chief regulators of corporate management, and strike suits comparatively rare,[48] fee awards to successful plaintiff-shareholders are hardly too much inducement.[49] The court in *Bechtel* pointed out that in order to receive such an award the plaintiff-shareholder must first win his suit, and even victory will net him no more than his fellow shareholder.[50] Thus it is unlikely an attorney would desire to support a derivative suit unless victory was substantially certain, and even if that were the case, it is doubtful that a shareholder would be susceptible to such a champertous attorney since the shareholder would generally stand to win nothing individually. Consequently, ethical considerations seem a questionable basis for opposition to the derivative rule.

More forceful reasons for denying attorneys' fees found expression in a recent Eighth Circuit case, *Missouri Pacific Railroad v. Slayton.*[51] In *Slayton*, management had proposed a consolidation plan to be voted on

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[44] 176 F. Supp. 781 (S.D.N.Y. 1956).

[45] *Id.* at 782.

[46] *Id.* at 783. On the other hand, some courts have expressed much doubt as to whether an attorney-shareholder should be allowed a fee award as attorney pro se in a derivative action if his holdings in the corporation are small. In such an action "considerable doubt is cast upon his good faith . . . ." Eisenberg v. Central Zone Property Corp., 1 App. Div. 2d 353, —, 149 N.Y.S.2d 840, 842 (1956), *aff'd mem.*, 3 N.Y.2d 729, 143 N.E.2d 516, 163 N.Y.S.2d 968, *cert. denied*, 355 U.S. 884 (1957). *But see* Giesecke v. Pittsburgh Hotels, Inc., 82 F. Supp. 64 (W.D. Pa. 1949), *aff'd*, 180 F.2d 65 (3d Cir. 1950).

[47] 244 Iowa 785, 56 N.W.2d 173 (1952).

[48] *Id.* at 804, 56 N.W.2d at 183.

[49] *Id.* at 807, 56 N.W.2d at 185.

[50] *Id.*

[51] 407 F.2d 1078 (8th Cir. 1969).

collectively. The stock situation was such that a collective vote would have effectively disfranchised Class "B" shareholders.[52] The Class "B" shareholders promptly instituted a class action to compel class voting and were ultimately successful in the Supreme Court.[53] Plaintiff-shareholders thereafter sought attorneys' fees and were initially successful against the corporate defendant in federal district court.[54] The court of appeals reversed the fee award,[55] however, reasoning that the unpredictability of litigation should not unnecessarily penalize one for bringing or defending a lawsuit and that courts should not be saddled with the burden of determining reasonable attorneys' fees.[56]

The difficulty with the *Slayton* rationale is that it loses sight of the equitable basis for fee awards, which is not to penalize anyone, but rather to distribute the expense of litigation among those who can be said to have benefited therefrom. While calculating reasonable attorneys' fees may be a difficult task, it is one which can and has been performed.[57] But even assuming awarding attorneys' fees to be a difficult task, the result to be reached certainly outweighs the burden.

A somewhat different problem which the Court in *Mills* addressed is whether the absence of statutory provision should preclude 14(a) fee awards. Section 14(a) of the Securities Exchange Act prescribes no

[52] The voting shares stood as follows:

Class A	1,856,277 shares
Class B	39,731 shares
Total	1,896,008 shares

The consolidation proposal according to management's plan would require a vote of 1,264,006 shares. Obviously, a collective vote would permit Class A shareholders to prevail by a comfortable margin. Slayton v. Missouri Pac. R.R., 279 F. Supp. 526 (E.D. Mo. 1968).

[53] Levin v. Mississippi River Fuel Corp., 386 U.S. 162 (1967).

[54] 279 F. Supp. at 526.

[55] 407 F.2d at 1082.

[56] *Id.*

[57] In many cases there may be no difficulty in calculating reasonable attorneys' fees. Where a fund is recovered, for instance, a percentage thereof can easily be awarded. The value of an attorney's services in other cases can be asertained by taking into consideration these factors: time necessarily spent on the case; amounts involved; amounts recovered; and the standing of the attorney(s) in the profession. *See, e.g.*, State *ex rel.* Weede v. Bechtel, 244 Iowa 785, 833-35, 56 N.W.2d 173, 199-202 (1952); Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658 (1956). Another factor that should perhaps be taken into consideration in awarding attorneys' fees is whether the corporation needed the proxy solicitation in order to go forward with the planned change. If, for instance, management has over the two-thirds votes necessary for the impending merger but decides to go ahead with a proxy solicitation which proves to be in violation of 14(a), shouldn't the fact that the proxy solicitation was an unnecessary formality be taken into consideration by the court awarding attorneys' fees?

attorneys' fees, whereas other sections of the Act make express provision therefor.[58] The Court resolved this problem by relying on a Second Circuit decision that awarded attorneys' fees in an action brought under section 16(b) which, like 14(a), contained no attorneys' fees provision.[59] Yet the Court considered it necessary to distinguish *Fleischman Corp. v. Maier Brewing Co.*[60] where it had disallowed a fee award for not being statutorily prescribed by the Lanham Act. *Fleischman*, however, was not a derivative suit and could easily have been distinguished on that ground. The Court was certainly correct in holding an absence of statutory provision should not be determinative of a fee award since such awards are traditionally equitable and have become the rule in derivative suits.

It should be borne in mind, however, that plaintiff-shareholders in *Mills* sued both derivatively and as a class. While the Court neglected to stress this distinction, it nonetheless relied on derivative cases to support its substantial benefit analysis.[61] On the other hand, 14(a) suits may be brought *directly*.[62] The question of whether a fee award may be granted in a direct action which substantially benefits the corporation has not been clearly decided.[63] Professor Henn indicates uncertainty in his treatment of the issue which suggests the following:

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[58] Securities Exchange Act of 1934 §§ 9(e) & 18(a), 15 U.S.C. §§ 78i(e) & 78r(a) (1964), specifically provide for an award of reasonable attorneys' fees in cases involving manipulation of security prices and misleading statements in documents filed with the SEC. Of course, the fact that a statute fails to make some specific provision has rarely restrained the Court from implying such a provision or otherwise reaching a result consistent therewith. The Court in *Mills* stated that "sections 9(e) and 18(a) should not be read as denying to the *courts* the power to award counsel fees in suits under other sections of the Act when circumstances make such an award appropriate . . . ." 396 U.S. 375, 390-91 (1970) (emphasis added).

[59] Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir. 1943).

[60] 386 U.S. 714 (1967). In *Fleischmann*, the Supreme Court affirmed an appellate court decision reversing a lower court award of attorneys' fees in a suit brought under the Lanham Act for trademark infringement. The opinion by Chief Justice Warren stated that where a statute creating the cause of action expressly provides remedies, other remedies should not readily be implied. The Court in *Mills* distinguished *Fleischmann* as involving a statute which meticulously detailed its remedies unlike the Securities Exchange Act of 1934.

[61] 396 U.S. 375, 395 (1970).

[62] J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

[63] *Compare* Riddell v. Cascade Paper Co., 56 Wash. 2d 663, 355 P.2d 3 (1960) (court found no substantial benefit in an individual shareholder action to determine voting rights) *with* Benson Co-op Creamery Ass'n v. First District Ass'n, 276 Minn. 520, 151 N.W.2d 422 (1967) (court noted plaintiff's action was for his *sole* benefit and "under these circumstances [did] not believe [it] should extend the right to recover attorneys' fees to this type of action.") *Id.* at 531, 151 N.W.2d at 429.

> Where the shareholder brings a direct . . . action and recovers a fund in behalf of a class, he should be reimbursed from such fund. Absent a class fund, *presumably* the normal rule that a litigant pays his own litigation expense should apply.[64]

Yet attorneys' fees should be recoverable in direct suits, provided the corporation substantially benefits. The problem with direct actions is that generally the benefits conferred thereby are purely individual. Certainly, the corporation will be substantially benefited by derivative actions more frequently than by direct actions due to the individual nature of the latter. If, however, a substantial benefit is shown accruing to the corporation as a result of a direct action, the fact that the action was not derivative should be no reason for denying a fee award. The essential *quaere* should be whether the corporation substantially benefited from the litigation, *not* whether the litigation producing the substantial benefit was direct or derivative. It is thus interesting to question whether 14(a) direct actions fall within the *Mills* rationale. Clearly, federal policy is not contingent upon the form in which a 14(a) claim is brought; and since the Court in *Mills* based its finding of a substantial benefit on federal policy, it should make no difference whether the 14(a) violation is uncovered derivatively or directly.

The next obvious step is an application of *Mills* to Section 10 of the 1934 Securities Exchange Act.[65] The core of this section and Rule 10b-5, promulgated thereunder, is "the implementation of the congressional purpose that all investors should have equal access to the rewards of participation in securities transactions."[66] It is presently the most dynamic tool in federal corporation law, and the federal policy is therefore certainly as strong behind 10b-5 as it is behind 14(a). When shareholders bring a successful 10b-5 derivative action, then, courts should have little difficulty finding a substantial benefit based on federal policy. Arguably, this finding should not differ in *direct* 10b-5 suits, since the federal policy does not change with the pleading form. Consequently, courts may transpose the federally grounded substantial benefit analysis in *Mills* to 10b-5 actions and thereby significantly develop federal corporation law.

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[64] H. HENN, LAW OF CORPORATIONS 798 (2d ed. 1970) (emphasis added).

[65] Securities Exchange Act of 1934 § 10, 15 U.S.C. § 78 (1964); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1970). Attorneys' fees have been held recoverable in one recent action brought under 10b-5, however, the decision made no reference to federal policy. Globus, Inc. v. Jaroff, 279 F. Supp. 807 (S.D.N.Y. 1968).

[66] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 851-52 (2d Cir. 1968).

Securities Regulation—Shareholder Derivative Suits Under Rule 14a-9

The judicial system continues to protect a corporate shareholder through implementation of the rapidly expanding anti-fraud provisions of the Securities Exchange Act of 1934.[1] In *Mills v. Electric Auto-Lite Co.*[2] plaintiff-shareholders brought a derivative suit and a class action in a federal district court seeking to set aside the merger of defendant Auto-Lite with another corporation.[3] As shareholders of Auto-Lite, plaintiffs alleged that management obtained proxies through materially false and misleading statements in violation of rule 14a-9.[4] In the proxy solicitations, management recommended a vote for the merger without indicating that Auto-Lite's directors were actually under the control of the corporation with which they contemplated merging.[5]

The district court, having found the defect in the solicitation to be material, granted plaintiffs' motion for summary judgment. On appeal, the Court of Appeals for the Seventh Circuit reversed as to the causal relationship holding that if Auto-Lite could show by a "preponderance of probabilities" that the merger was fair and would have received

[1] Securities Exchange Act of 1934 §§ 10(b) & 14(a), 15 U.S.C. §§ 78j(b) & 78n(a) (1964).

[2] 396 U.S. 375 (1970).

[3] 396 U.S. at 377-78. The complaint, filed the day before the shareholder's meeting, sought an injunction against the voting of proxies obtained by allegedly misleading solicitations. However, a temporary restraining order was not sought and the voting took place as scheduled. After the merger, the complaint was amended to seek retrospective relief.

[4] 17 C.F.R. § 240.14a-9(a) (1970), provides in part:

> No solicitation subject to this regulation shall be made by means of any proxy statement . . . containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact . . . necessary in order to make the statements therein not false or misleading . . . .

This rule was promulgated under Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (1964), which provides in part:

> It shall be unlawful for any person . . . to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security . . . in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[5] In the 108 page solicitation Auto-Lite's management recommended a vote for the merger in bold type on page two of the pamphlet. A limited textual treatment of the relationship between the merging corporations was set forth on the same page with less emphasis. Statistical information relevant to this relationship was displayed on pages 21-23 of the same pamphlet. The position of these statements in the solicitation seemed critical to the circuit court in ruling that the misrepresentations had been material. Mills v. Electric Auto-Lite Co., 403 F.2d 429, 433 (7th Cir. 1968).

sufficient votes in any event, no reason would exist for setting aside the merger. The Supreme Court granted certiorari to determine the causal relationship that had to be shown between the solicitation and the subsequent merger in order to establish a shareholder's cause of action.

The Supreme Court followed a two stage analysis. A defect or omission in a proxy solicitation must first be found to be material; *i.e.* "of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote."[6] Once materiality is established, the necessary causal relationship exists if "the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction."[7] In this posture the case was remanded to consider the question of relief.

The Court's adoption of a reasonable man test in determining the materiality of a defect or omission was predictable. The materiality test formulated under section 10(b) of the Securities Act[8] was easily adapted to the situation of proxy solicitations.[9] Despite the fact that disputes may arise as to what is "material," the reasonable man standard perhaps gives the uninformed shareholder the maximum amount of protection possible. While the lack of a precise definition of materiality may perplex management, it is not unfair to require complete disclosure of factually sound information in order to protect shareholder voting rights. The shareholder must necessarily accept as true the information management forwards to him. It is far better that he have too much information at his disposal than too little.[10]

The main advantage offered by the materiality test set forth in *Mills*

[6] 396 U.S. at 384.

[7] *Id.* at 385.

[8] *E.g.*, SEC v. Great Am. Indus., Inc., 407 F.2d 453, 459-60 (2d Cir. 1968), *cert. denied*, 395 U.S. 920 (1969); Rogen v. Ilikon Corp., 361 F.2d 260, 266 (1st Cir. 1966); List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965), *cert. denied*, 382 U.S. 811 (1965); 3 L. Loss, SECURITIES REGULATION, 1431 n.5 (2d ed. 1961) [hereinafter cited as Loss].

[9] *E.g.*, General Time Corp. v. Talley Indus., Inc., 403 F.2d 159, 162 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969); Gerstle v. Gamble-Skogmo, Inc., 298 F. Supp. 66, 97 (E.D.N.Y. 1969); Walpert v. Bart, 280 F. Supp. 1006, 1011 (D. Md. 1967), *aff'd per curiam*, 390 F.2d 877 (4th Cir. 1968).

[10] Too much information, however, can be as harmful as too little. Where a lengthy solicitation is involved, perhaps a short summary containing basic information on the merging companies should be required. A similar proposal would require that a shortened solicitation form be mailed to the shareholder separately from cumbersome financial statements. Sowards, *The Wheat Report and Reform of Federal Securities Regulation*, 23 VAND. L. REV. 495, 530-32 (1970).

is that courts can mold the test to varying factual situations in order to achieve the most equitable result. Thus it is anticipated that the materiality of a defect will be easily established. The pertinent inquiry, however, is what causal connection must be shown between the material defect and the resulting injury.[11] As the Court in *Mills* indicated, once materiality of a defect or omission is established plaintiff-shareholders' burden of proving a causal connection between the solicitation and the merger is considerably lightened.

The express language in *Mills* indicates that a causal relationship between the misleading solicitations and the alleged injury is established by showing first a material defect or omission and second that the solicitation, not the defect itself, was an *essential link* in the transaction.[12] This test of causation certainly eliminates subjectivity and to that extent favors the plaintiff-shareholder.[13] It is at least clear that reliance on the defect by each shareholder who authorized his vote by proxy will no longer be required to establish a cause of action.[14] But other parts of the decision are not so clearly resolved. The Court fails to follow its own admonition that they deal "in an area where glib generalizations and unthinking abstractions are major occupational hazards."[15] Instead, the Court left room for interpretation in two distinct areas.

[11] Since a private cause of action under the proxy rules was established in J.I. Case Co. v. Borak, 377 U.S. 426 (1964), the cases have indicated that the necessity of establishing a causal relationship is the critical issue. The conflict centered in the Second Circuit, one district holding that allegations of a causal relationship were essential to plaintiff's claim and conclusory allegations might be insufficient, while another district held the contrary. *Compare* Robbins v. Banner Indus., 285 F. Supp. 758, 763 (S.D.N.Y. 1966) *and* Barnett v. Anaconda Co., 238 F. Supp. 766, 773 (S.D.N.Y. 1965) *with* Gerstle v. Gamble-Skogmo, Inc., 298 F. Supp. 66, 98 (E.D.N.Y. 1969) *and* Laurenzano v. Einbender, 264 F. Supp. 356, 362 (E.D.N.Y. 1966).

[12] 396 U.S. at 385. In addition, the test may impliedly resolve the troublesome question of *partial invalidity*. Where a misrepresentation has been made in one aspect of a solicitation, and that aspect can be isolated from the other truthful parts, it has been held that the solicitation would only be invalid as to the misrepesented part. SEC v. Transamerica Corp., 67 F. Supp. 326, 329 (D. Del. 1946), *aff'd*, 163 F.2d 511 (3d Cir. 1947), *cert. denied*, 332 U.S. 847 (1948). By addressing the entire solicitation, the *Mills* test would seem to preclude isolation of the misrepresented part. *See generally* Loss 972-73.

[13] 396 U.S. at 385.

[14] *Id.* at 384-85. See also Berman v. Thomson, 312 F. Supp. 1031, 1033 (N.D. Ill. 1970). The Court in *Mills* perhaps anticipated the expansion of the reliance concept seen in rule 10b-5 into actions brought under rule 14a-9. See W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING 103-18 (1968) [hereinafter cited as PAINTER].

[15] SEC v. National Sec., Inc., 393 U.S. 453, 465 (1969).

Of initial concern is the meaning of the term *essential link*. Although several definitions are possible,[16] the Court apparently viewed the term as meaning that a solicitation of proxies was *necessary* in order to approve the merger.[17] For example, in *Mills* management controlled fifty-four percent of the voting stock but needed two-thirds of all outstanding shares to approve the merger.

Defining *essential link* in terms of what is *necessary* to accomplish a particular transaction tends to be rather restrictive in light of the policy of protecting minority shareholders. Of particular concern is the unusually rare situation in which management controls a sufficient number of votes to execute the merger without the necessity of securing proxies. For example, if management controls seventy-three percent of the voting stock when only a two-thirds vote is required to execute the merger,[18] votes cast by proxy could not possibly alter the certainty of merger, and, according to a strict interpretation of *Mills*, the solicitation would not be an *essential link*. In this situation management, through the solicitation, is not seeking unnecessary proxies; rather, it has chosen the proxy solicitation as the mode of communication whereby shareholders may become "informationally competent to deliberate corporate matters."[19] Management may be prompted to include material misrepresentations in a proxy solicitation if it fears that truthful disclosure and informed debate might preclude efficient execution of the merger. If a proxy solicitation can be viewed as a communicative device, then perhaps the *essential link* requirement can be satisfied by showing that fully informed shareholders conceivably could have altered the voting outcome through informed debate at the shareholder's meeting.[20] By defining *essential link* in these terms, protection is extended to the maximum number of shareholders.

Of lesser concern is the Court's synonymous use of the terms "merger" and "injury." It is arguable that confusion could result from a misreading

[16] For example, the Court might have been considering what is legally required by the proxy rules. Rule 14(c) provides that solicitations or substantially equivalent information will be provided the shareholder prior to any stockholder meeting. 15 U.S.C. § 78n(c) (1964), *amending*, Securities Exchange Act of 1934, ch. 404, § 14, 48 Stat. 895 (1934).

[17] In a footnote the Court explicitly stated that it addressed only the situation where votes cast by authority of proxies were necessary to control the outcome of the merger. 396 U.S. at 395 n.7. Yet it cited with apparent approval Laurenzano v. Einbender, 264 F. Supp. 356 (E.D.N.Y. 1966), where the shareholder's cause of action was established even though proxies were not necessary to accomplish the merger.

[18] Barnett v. Anaconda Co., 238 F. Supp. 766 (S.D.N.Y. 1965).

[19] Laurenzano v. Einbender, 264 F. Supp. 356, 362 (E.D.N.Y. 1966).

[20] *Id.*

of the opinion is the area of relief to be afforded a plaintiff-shareholder.[21] The relief sought in *Mills* was the unwinding of the merger;[22] the "merger" and the "injury" were one in the same. The injury, however, may be quite separate and distinct from the merger. The most obvious example is that the market price of the corporate share might suffer as a result of a merger. In addition to the unwinding of the merger, plaintiff-shareholder should certainly be entitled to damages for any financial loss suffered, but he should be required to show that the merger did in fact cause the injury. Financial loss, however, is not an essential ingredient of a shareholder's cause of action, for requiring such an injury would preclude effective enforcement of the proxy solicitation rules.[23]

One problem which can be anticipated in the near future is the expansion of *Mills* into the area of rule 10b-5.[24] Rule 14a-9 and rule 10b-5 overlap to the extent that a merger usually results in the issuance of stock certificates under the name of the newly formed corporation, and the shareholder, because of this new issue, is classified as a "purchaser" of securities.[25] Coverage under one of the rules does not preclude coverage under the other,[26] and in fact most cases involving 14a-9 violations assert causes of action under both anti-fraud provisions.[27] Both rules were designed to prevent the "insider" from profiting at the expense of the uninformed shareholder.[28] Hence, the judicial guidelines encountered

[21] Twice in his opinion Justice Harlan poses the problem before the Court as being the relationship between the misleading solicitation and the merger, but the holding is expressed in terms of the relationship between the solicitation and the shareholder's injury. 396 U.S. at 377, 385.

[22] Plaintiff-shareholders also sought attorneys' fees. See Note, *Securities Regulation—Allowance of Attorneys' Fees in 14(a) Derivative Suits*, 49 N.C.L. REV. 204 (1970).

[23] Berman v. Thomson, 312 F. Supp. 1031, 1033 (N.D. Ill. 1970).

[24] 17 C.F.R. § 240.10b-5 (1970), provides in part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality
>
> . . . .
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . .
>
> . . . .
>
> in connection with the purchase or sale of any security.

[25] In SEC v. National Sec. Inc., 393 U.S. 453, 467 (1969), a re-issuing of stock certificates following a merger was held to be a "purchase or sale" sufficient to satisfy the requirement of rule 10b-5. *See also* Dasho v. Susquehanna Corp., 380 F.2d 262, 266 (7th Cir.), *cert. denied*, 389 U.S. 977 (1967).

[26] SEC v. National Sec., Inc., 393 U.S. 453, 468 (1969).

[27] *E.g.*, SEC v. National Sec., Inc., 393 U.S. 453 (1969); Gerstle v. Gamble-Skogmo, Inc., 298 F. Supp. 66 (E.D.N.Y. 1969); 6 Loss 3613-14.

[28] PAINTER 264.

under either rule can be readily applied to a particular situation to give utmost effect to congressional policy. The most obvious example[29] is the reasonable man standard for determining materiality promulgated under rule 10b-5, but now utilized in cases brought under the proxy solicitation rules.[30]

The application of a single standard to an action brought under both rules would lend uniformity to the enforcement of the Securities Act. However, certain judicial standards may be designed peculiarly for one rule or the other. At present, an action brought under rule 10b-5 requires the plaintiff to establish some causal relationship between the misrepresentation and the purchase or sale of securities.[31] Whether expressed in terms of reliance, privity, or causation[32] this causal requirement is designed, in part, to identify the proper party plaintiff. It establishes some "rational means of deciding who, among those trading through the vastly impersonal medium of an exchange or over-the-counter market, should recover and who should not."[33] Thus the causation requirement actually serves to limit defendant's liability to a defined group of individuals. On the other hand, the proper party to bring an action under rule 14a-9 is readily defined; he is the shareholder of the corporaiton to whom the misleading solicitation was sent. Relaxation of the causation requirement in this instance does not increase the scope of defendant's liability, but merely makes enforcement of the proxy rules easier by decreasing the shareholder's burden of proof. Because of the peculiar function served by the causation requirement under rule 10b-5—limiting the scope of defendant's liability through identification of the proper party plaintiff—it is anticipated that the abandonment of the causation requirement set forth in *Mills* will not be extended into the area of rule 10b-5.

Even though causality is required under rule 10b-5, strong protection is afforded the corporate shareholder. The reasonable man test of materiality leaves vast room for judicial construction in the individual case.[34]

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[29] *See* notes 8 & 9 *supra.*

[30] The most recent example of the adaptability of judicial standards between these two anti-fraud provisions is found in Berman v. Thomson, 312 F. Supp. 1031 (N.D. Ill. 1970), wherein the court applied the rationale of SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 854-56 (2d Cir. 1968), a 10b-5 case, to an action brought under rule 14a-9 and concluded that good faith on the part of management was no defense.

[31] One commentator indicates that causation but not reliance is essential to plaintiff's cause of action. PAINTER 109.

[32] *Id.* at 103-18.

[33] *Id.* at 112.

[34] An issue presented in Berman v. Thomson, 312 F. Supp. 1031 (N.D. Ill.

The shareholder need not show a financial injury to maintain his cause of action, for such a requirement would frustrate the enforcement of the proxy solicitation rules.[35] Moreover, the two anti-fraud provisions of the Securities Act usually lend support to one another as the shareholder is increasingly given more protection. An unfortunate consequence of the judiciary's continued support of minority shareholders is evidenced by the power that they possess to control the outcome of corporate activities. Indeed, the day looms near when a corporation may stand at the mercy of one insignificant, discontented shareholder.[36] The corporate merger has become at best a tenuous relationship. As a matter of public policy, perhaps some degree of protection should be given a corporate merger already consummated.[37] Indeed, the judiciary should possibly reconsider their interpretation of the Securities Act.

E. L. KITTRELL SMITH

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Torts—Mental Distress Damages for Racial Discrimination

In *Massachusetts Commission Against Discrimination v. Franzaroli*[1] the Commission Against Discrimination[2] found that Mandred Henry, a Negro, had been denied an apartment by the defendants solely because of his race. The commission ordered cessation of defendants' discriminatory rental practices[3] and awarded Henry compensation for his increased ex-

1970), was whether materiality should be determined by the jury or by the court. It was held that when reasonable minds could not differ, the question of materiality could be decided by the court. Although the judiciary has traditionally used this standard to withhold issues from the jury, it would appear that the jury is especially suited to determine whether a reasonable man would or would not have been misled. Indeed, when a merger may stand or fall on such a fine distinction as the materiality of information contained in a footnote of a solicitation, perhaps the question of materiality should always be for the jury.

[35] *Id.* at 1033.

[36] Perhaps the individual minority shareholder is not so powerful. In Rekant v. Dresser, 425 F.2d 869, 876 n.7 (5th Cir. 1970), the court noted that although the individual shareholder has a powerful weapon in section 10(b), he occupies a fiduciary relationship with other shareholders as a consequence of his bringing suit. This same fiduciary capacity is presumably shared by the plaintiff-shareholder in a suit under section 14(a).

[37] *See generally* 2 Loss 956-71.

[1] — Mass. —, 256 N.E.2d 311 (1970).

[2] See MASS. ANN. LAWS ch. 152B, §§ 1-10 (1957), which outlines the powers and duties of the anti-discrimination commission.

[3] *Id.* ch. 151B, § 4 (1946), which prohibits discrimination in apartment rental.

pense in commuting to work, his loss of time and his mental suffering.[4] The Massachusetts Supreme Court upheld the commission's order.[5] The compensation to Mr. Henry for his "considerable frustration, anger, and humiliation"[6] is particularly noteworthy. Mental distress is often the predominant and sometimes the only injury in discrimination cases,[7] and increased potential for redress of that injury must necessarily affect the nature and attractiveness of this type of litigation.

Compensation for mental distress in discrimination cases has been rare,[8] and has usually been based upon statute.[9] *Franzaroli* is, to a certain extent, in accord with this norm. The Massachusetts statute prohibiting discrimination in apartment leasing authorizes an award of

> damages not to exceed one thousand dollars, which damages shall include, *but shall not be limited to,* the expense incurred by the petitioner for obtaining alternative housing or space, for storage of goods and effects, for moving and for other cost actually incurred by him as a result of such unlawful practice or violation. . . .[10]

Since the statute does not specifically provide for compensation for mental distress, the commission's award of such damages may provide precedent for mental distress damages under similar statutes in other states.[11]

The Massachusetts Supreme Court could have concentrated its attention solely upon the statute and attempted to resolve its neutrality by an exercise in statutory interpretation.[12] However, the court buttressed its decision by resorting to common law precedent,[13] thereby broadening

[4] *Id.* ch. 151B, § 5 (Supp. Vol. 4-C, 1965), which provides damages for discrimination in apartment leasing.

[5] The superior court had modified the ruling of the commission by deleting damages. — Mass. —, —, 256 N.E.2d 311, 312 (1970).

[6] *Id.* at —, 256 N.E.2d at 312.

[7] *See* Duda, *Damages for Mental Suffering in Discriminaiton Cases,* 15 CLEV.-MAR. L. REV. 1, 6 (1966).

[8] *Id.* at 3.

[9] *See, e.g.,* Amos v. Prom, Inc., 115 F. Supp. 127 (N.D. Iowa 1953).

[10] MASS. ANN. LAWS ch. 151B, § 5 (Supp. Vol. 4-C, 1965) (emphasis added).

[11] *See* COLO. REV. STAT. § 25-1, -2 (1953); ILL. ANN. STAT. ch. 14, § 9 (1963); MINN. STAT. ANN. § 327.09 (1966); PA. STAT. ANN. tit. 18, § 4654 (1963); WASH. REV. CODE § 9.91.010 (1961).

[12] A tenable argument may be made that the criminal fine provided in MASS. ANN. LAWS ch. 272, § 92 (1934), enforcing the prohibition against discrimination in public accommodations in MASS. ANN. LAWS ch. 272, § 98 (1934), indicates a legislative intent to compensate mental distress. Many of the situations covered by the statute would not involve pecuniary loss for the injured party. See also Crawford v. Robert L. Kent, Inc., 341 Mass. 125, 167 N.E.2d 620 (1960); Bryant v. Rich's Grill, 216 Mass. 344, 103 N.E. 925 (1914).

[13] — Mass. at —, 256 N.E.2d at 313.

the scope and import of *Franzaroli*. Recovery for mental distress has been allowed in Massachusetts as an aspect of "total compensation" in cases involving wrongful eviction,[14] unlawful expulsion from school,[15] and wrongful removal from public office.[16] Arguably, the fact situation in *Franzaroli* is distinguishable since original exclusion from a school, a job, or a home is not as disruptive and harmful as expulsion. Further, *Franzaroli* did not involve an existent contractual relationship, violation of which has been recognized as a basis for mental distress recovery.[17]

Courts have been quite willing to award damages for mental distress when a recognized cause of action is independently established.[18] Since in the fields of housing and public accommodations there is a statutory right to be free from racial discrimination,[19] a violation may establish an independent cause of action of sufficient import to provide a "peg"[20] on which to hang mental distress damages. An analysis of Massachusetts precedent seems to support this conclusion. In *Stiles v. Municipal Council of Lowell*[21] the Massachusetts court implied that a wrongful act—unlawful removal from public office—was actionable as a distinct tort[22] and recognized mental distress as a "natural consequence" of that act.[23] Since both *Franzaroli* and *Stiles* relied upon the same line of precedent[24] to support rewards for mental suffering, *Franzaroli* may reasonably be interpreted to be based upon the theory of recovery established by the language in *Stiles*.

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[14] Fillebrown v. Hoar, 124 Mass. 580 (1878).

[15] Morrison v. Lawrence, 181 Mass. 127, 63 N.E. 400 (1902).

[16] Stiles v. Municipal Council of Lowell, 233 Mass. 174, 123 N.E. 615 (1919).

[17] Duff v. Engelberg, 237 Cal. App. 2d 594, 47 Cal. Rptr. 114 (1965) (interference with contract); Stewart v. Rudner, 349 Mich. 459, 84 N.W.2d 816 (1957) (breach of contract).

[18] Gadsen Gen. Hosp. v. Hamilton, 212 Ala. 531, 103 So. 553 (1925) (false imprisonment); Trogdon v. Terry, 172 N.C. 540, 90 S.E. 583 (1916) (assault); Draper v. Baker, 61 Wis. 450, 21 N.W. 527 (1884) (battery).

[19] MASS. ANN. LAWS ch. 151B, § 4 (1946) prohibits discrimination in housing; MASS. ANN. LAWS ch. 272, § 98 (1934) prohibits discrimination in public accommodations.

[20] W. PROSSER, LAW OF TORTS 44 (3d ed. 1964).

[21] 233 Mass. 174, 123 N.E. 615 (1919).

[22] *Id.* at 184-85, 123 N.E. at 616.

[23] "The rule is well settled, however, that if the natural consequence of the wrongful act, done wilfully or with gross negligence, is mental suffering to the plaintiff, then that element may be considered in assessing damages." *Id.* at 185, 123 N.E. at 617.

[24] The precedent for each case was Lombard v. Lennox, 155 Mass. 70, 28 N.E. 1125 (1891); Fillebrown v. Hoar, 124 Mass. 580 (1878); Meagher v. Driscoll, 99 Mass. 281 (1868). *See* — Mass. —, —, 256 N.E.2d 311, 313 (1970); 233 Mass. 174, 185, 123 N.E. 615, 617-18 (1919).

A logical and crucial extension of the rationale in *Franzaroli* is the availabilty of damages under the common law tort of intentional infliction of mental distress.[25] When there is no physical impact, manifestation of physical injury, or other actual damages, mental distress as a distinct tort may be the only appropriate cause of action. However, the requirements for recovery for intentional infliction of mental distress are quite rigid. There must be either intentional or reckless disregard for the injured party's sensibilities, and the emotional harm must be severe. The conduct causing the injury must be such as a reasonable man would consider "outrageous."[26] It is doubtful that a single covert act of discrimination unaccompanied by aggravating conduct would be sufficient to meet the "outrageous"[27] or the "severe emotional harm"[28] test.

Nevertheless, in determining liability, all of the circumstances surrounding the alleged injury are important; courts have systematically categorized certain factors and recognized their effect upon recovery.[29] One such factor is the peculiar sensitivity of the plaintiff to emotional harm. Thus in *Nickerson v. Hodges*[30] an elderly woman, once an inmate in a mental hospital, was made the subject of a practical joke. The court, despite the absence of physical injury, allowed recovery because her age and state of mind made her vulnerable to the humiliation. Another line of cases[31] involving pregnant women and persons in poor health is analytically in accord with the rationale of *Hodges*. Although a factual

[25] *See* RESTATEMENT (SECOND) OF TORTS § 46 (1965); *see also* State Rubbish Collection Ass'n v. Siliznoff, 38 Cal. 2d 330, 240 P.2d 282 (1952); Great A & P Tea Co. v. Roch, 160 Md. 189, 153 A. 22 (1931); Johnson v. Sampson, 167 Minn. 203, 208 N.W. 814 (1926).

[26] RESTATEMENT (SECOND) OF TORTS § 46 (1965).

[27] *But cf.* Holland v. Edwards, 307 N.Y. 38, 119 N.E.2d 581 (1954), in which Justice Fuld provides a reminder that when a man practices discrimination it is likely that "he will pursue his discriminatory practices in ways that are devious, by methods subtle and elusive . . . ." *Id.* at 45, 119 N.E.2d at 584.

[28] *But see* Colley, *Civil Action for Damages Arising out of Violations of Civil Rights*, 17 HAST. L.J. 189 (1965), for a contention that racial discrimination is "devastating and enduring when inflicted upon adults." *Id.* at 201.

[29] *E.g.*, Blecker v. Colo. & S.R.R., 50 Colo. 140, 114 P. 481 (1911) (relationship between common carriers and their passengers); De Wolf v. Ford, 193 N.Y. 397, 86 N.E. 527 (1908) (relationship between innkeepers and their guests).

[30] 146 La. 735, 84 So. 37 (1920).

[31] Clark v. Associated Retail Credit Men, 105 F.2d 62 (D.C. Cir. 1939); Alabama Fuel & Iron Co. v. Baladoni, 15 Ala. App. 316, 73 So. 205 (1916); Patapasco Loan Co. v. Hobbs, 129 Md. 9, 98 A. 239 (1916); Continental Casualty Co. v. Garrett, 173 Miss. 676, 161 So. 753 (1935); National Life & Acc. Ins. Co. v. Anderson, 187 Okla. 180, 102 P.2d 141 (1940); Pacific Mut. Ins. Co. v. Tetirick, 185 Okla. 37, 89 P.2d 774 (1938). *Contra*, Bartow v. Smith, 149 Ohio St. 301, 78 N.E.2d 735 (1948).

distinction is possible since the emotional harm in each case had physical manifestations, no liability would have arisen except for the special condition of the plaintiffs.

Recognition of peculiar sensitivity to emotional harm seems particularly pertinent to instances of racial discrimination, and there is some precedent that applies this view. In a federal case,[32] involving a Negro woman who was required to move from a reserved seat to an "all colored" section of a train, the court alluded to the woman's particular vulnerability to embarassment. The court referred to the woman as a lady of "refinement"[33] which might, in part, explain her vulnerability in non-racial terms.[34] However, implicit in the case is that the inferior status connoted by defendant's action could have had an impact only upon the sensibilities of a Negro.

Of even more significance is *Alcorn v. Anbro Engineering, Inc.*,[35] a recent California case in which a Negro truck driver was subjected to abusive insults and racial slurs by his employer. The court recognized the special vulnerability of a Negro as a definite factor to be considered in determining whether the defendant's conduct was actionable.[36] *Alcorn*, of course, involved more blatant behavior than was present in *Franzaroli*. Furthermore, the plaintiff in *Alcorn* suffered physical manifestations of his emotional harm. The California court decided that the complaint was sufficient to withstand a demurrer,[37] but was inconclusive on whether less culpable behavior would have been actionable. However, the court did indicate that the presence of physical injury was not essential to recovery.[38] Since the California extension of peculiar susceptibility to persons exposed to racial discrimination is rationally sound, the decision may presage its general recognition in discrimination cases.

One problem inherent in the application of the peculiar susceptibility theory is whether it should be a factor considered in all mental distress cases involving racial minorities, or whether each case must be considered

[32] Solomon v. Pennsylvania R.R., 96 F. Supp. 709 (S.D.N.Y. 1951)

[33] *Id.* at 710.

[34] The recovery for mental distress may be also rationalized on the basis of the special obligation which a common carrier owes a passenger. *E.g.*, Wolfe v. Georgia Ry. & Elec. Co., 2 Ga. App. 499, 58 S.E. 899 (1907); Haile v. New Orleans Ry. & Light Co., 135 La. 230, 65 So. 225 (1914); Gillespie v. Brooklyn Heights R.R., 178 N.Y. 347, 70 N.E. 857 (1904).

[35] 2 Cal. 3d 493, 468 P.2d 216, 86 Cal. Rptr. 88 (1970).

[36] *Id.* at —, 468 P.2d at 218-19, 86 Cal. Rptr. at 90-91.

[37] *Id.*

[38] *Id.* at —, 468 P.2d at 218, 86 Cal. Rptr. at 90.

individually to determine if the particular plaintiff is, in fact, peculiarly susceptible. The California court in *Alcorn* intimated that the peculiar susceptibility of a particular plaintiff is a determination to be entrusted to the trier of fact in the individual case.[39]

The doctrine of peculiar susceptibility serves two functions in cases involving intentional infliction of mental distress. In determining whether conduct is "outrageous," defendant's conscious disregard of uniquely vulnerable sensibilities of a class is one of the factors to be considered.[40] In this respect, the actual susceptibility of the individual plaintiff is not crucial. For example, subjecting a pregnant woman to a cruel practical joke is made more culpable because of the woman's condition, irregardless of the particular woman's actual vulnerability. If a class is generally susceptible to a certain type of emotional harm, conduct calculated to cause that harm is no less blameworthy because the individual plaintiff fortuitously does not share the general vulnerability.

On the other hand, the second purpose of the peculiar susceptibility doctrine does depend upon its applicability to the particular plaintiff. The unusual vulnerability of an individual to a certain type of emotional injury gives assurance of the truthfulness of an allegation of mental distress.[41] For the assurance to be meaningful the actual susceptibility of the plaintiff must be established. This may be accomplished in the racial discrimination context, for example, by offering evidence that the plaintiff has always been sensitive to racial insults. Such evidence is not essential, though, since the fact that the plaintiff is a Negro is itself evidence of the likelihood of his susceptibility. Still, the trier of fact must decide, based upon the class's vulnerability or specific evidence, whether the plaintiff was actually susceptible.

It is enlightening at this point to probe into the justifications for the stringent requirements for mental distress damages within the racial discrimination context. Strict criteria are necessary, for there is a real danger that mental distress litigation could degenerate into the realm of the trivial, involving the judicial process in attempts to redress petty annoyances.[42] Insistence upon "outrageousness" mitigates against this

[39] *Id.* at — n.4, 468 P.2d at 219 n.4, 86 Cal. Rptr. at 91 n.4.
[40] RESTATEMENT (SECOND) OF TORTS § 46, comment f (1965).
[41] *Id.*, comment j.
[42] "Adoption of the suggested principle would open up a wide vista of litigation in the field of bad manners, where relatively minor annoyances had better be dealt with by instruments of social control other than the law." Magruder, *Mental and Emotional Disturbance in the Law of Torts*, 49 HARV. L. REV. 1033, 1035 (1936).

eventuality.[43] Conversely, racial discrimination in housing and public accommodations results in unreasonable denial of access to essential services. Legislatures, both state and federal, have responded to the critical nature of this denial by enacting a myriad of civil rights laws[44] reflecting society's belief that precluding a man, on the basis of his race, from obtaining housing for his family is a matter of grave concern. Likewise, the mental distress caused by this discrimination is not the product of a petty annoyance.

The alleged vagueness and the speculative nature of mental distress damages have caused courts considerable apprehension.[45] By setting up a very rigid standard, liability is limited to injurious behavior of exceptional gravity, thereby minimizing the danger of fictitious claims.[46] However, the intense statutory prohibition on discrimination can reasonably be interpreted as legislative recognition that acts of discrimination are harmful; since implicit in an act of discrimination is a connotation of inferiority, much of that harm must be emotional. The studies of social scientists have underscored the devastating effects of discrimination; exemplary is the statement:

> Self-hatred and feelings of inferiority are not, of course, rational or effective responses, but they are among the natural results of the pressures acting upon a minority group. The suffering which discrimination causes . . . "may be aggravated by consciousness of incurability and even blameworthiness, a self-reproaching which tends to leave the individual still more aware of his loneliness and unwantedness . . . . The dominant sociopsychological pressure of color prejudice seems to produce a collapsing effect upon the individual's self-respect—to render him ashamed of his existence."[47]

In fact, the United States Supreme Court in *Brown v. Board of Education*[48] recognized and articulated the emotional harm resulting from discrimination.[49] It is, then, incongruous to have broadly based recog-

[43] Prosser, *Insult and Outrage*, 44 CAL. L. REV. 40, 44 (1956) [hereinafter cited as Prosser].

[44] *See* J. GREENBERG, RACE RELATIONS AND AMERICAN LAW, 372-400 (1959).

[45] "Such injuries are generally more sentimental than substantial." Wadsworth v. Western Union Tel. Co., 86 Tenn. 695, 721, 8 S.W. 574, 582 (1888) (dissenting opinion). *See also* Harned v. E-Z Finance Co., 151 Tex. 641, 649-50, 254 S.W.2d 81, 86-87.

[46] Prosser, *supra* note 43, at 44-45.

[47] G. SIMPSON & J. YINGER, RACIAL AND CULTURAL MINORITIES 217 (1958).

[48] 347 U.S. 483 (1954).

[49] Chief Justice Warren writing for the Court stated that segregation "generates

nition, including legislative and judicial notice, of the mental suffering caused by discrimination and still preclude recovery for fear that the alleged harm is fictitious.

The final concern that must be considered is the possibility of an unhealthy flood of litigation resulting from the recognition of a new interest.[50] A finding of fact that racial discrimination has been practiced is a condition precedent to recovery for mental distress. Special judicial machinery has already been established in many states to handle this litigation.[51] Furthermore, a recent federal case[52] indicates that damages in discrimination cases do not require a jury trial; mental distress damages could therefore be awarded by anti-discrimination commissions. Such procedure would place no additional burden upon the courts.

The tort of intentional infliction of mental distress has been carefully and perhaps prudently circumscribed by the courts. Within the context of racial discrimination in housing and public accommodations, however, the rationale behind the strict limitations does not retain validity. Given this invalidity, a new, more liberal standard should be applied in mental distress cases in this area. Further, given the appropriateness of the peculiar susceptibility theory established by *Alcorn*, recovery for mental distress may be available under the traditional criteria. Finally, *Franzaroli* provides a rationale for recovery for mental suffering based upon the independently actionable nature of racial discrimination. On at least one of these theories, the genuine emotional suffering engendered by discriminatory exclusion from essential services should be compensated.

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a feeling of inferiority as to [Negro school children's] status in the community that may affect their hearts and minds in a way unlikely ever to be undone." *Id.* at 494.

[50] *E.g.*, Simone v. Rhode Island Co., 28 R.I. 186, 192, 66 A. 202, 204-05 (1907).

[51] For reference to states having commissions against discrimination see J. GREENBERG, RACE RELATIONS AND AMERICAN LAW 384-85 (1959).

[52] Rogers v. Loether, 312 F. Supp. 1008 (E.D. Wis. 1970); however, this case represents a significant break with substantial precedent. *See* Ross v. Bernhard, 396 U.S. 531 (1970); Dairy Queen, Inc. v. Wood, 369 U.S. 469 (1962); Beacon Theatres, Inc. v. Westover, 359 U.S. 500 (1959). Consequently, the validity of the case as precedent may be questioned.